2018 Edition

Trusts to Protect Your Assets from Medicaid

MEDICAID SECRETS EBOOK SERIES

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K. GABRIEL HEISER, Attorney

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Published by:

Phylius Press

Phylius Press
PMB # 236-M
220 N Zapata Hwy Ste 11
Laredo TX 78043-4464
info@phyliuspress.com

For additional copies:
www.MedicaidSecrets.com

ABOUT THE AUTHOR

K. Gabriel Heiser, J.D., has focused exclusively on estate planning and Medicaid eligibility planning, including trusts, estates, gifts, and related tax issues, since graduating from Boston University School of Law in 1983. He also practiced in Massachusetts, where he was Chairman of the Estate Planning Committee of the Massachusetts Bar Association, and in Tennessee, where he was the founder and first Chairman of the Nashville Bar Association's Estate Planning Committee and where he served as President of the Middle Tennessee Planned Giving Council (1997). Although recently retired from the active practice of law, during his 25-year career he was a long-time member of the National Academy of Elder Law Attorneys (NAELA), a Fellow of the American College of Trust and Estate Counsel (ACTEC)—the highest designation for trust and estate attorneys in the U.S.—and was AV® rated by Martindale-Hubbell®, the country's preeminent lawyer peer rating service.

Attorney Heiser has been a frequent seminar leader and participant in the areas of estate and gift tax, charitable gifts and trusts, Medicaid eligibility planning, and sophisticated estate planning. He has taught as a member of the Adjunct Faculty of the College for Financial Planning at David Lipscomb University, as an instructor in Estate Planning Law (1996-1998), and has been certified as an Estate Planning Law Specialist by The Estate Law Specialist Board, Inc., the only American Bar Association-accredited program for certification of an attorney as an estate planning specialist.

Fellow, American College of Trust and Estate Counsel (ACTEC): Being elected to ACTEC is one of the highest honors an estate planning attorney can receive. ACTEC is a non-profit association composed of approximately 2,600 of the most accomplished estate planning practitioners in the United States and Canada. A lawyer cannot apply for membership in the College; Fellows of the College are nominated by other Fellows in their geographic area and are elected by the membership at large. To qualify for membership, a lawyer must have at least 10 years of experience in the active practice of probate and trust law or estate planning. Lawyers and law professors are elected to be Fellows by the other members, based on their outstanding professional reputation, exceptional skill, and substantial contributions to the field by lecturing, writing, teaching and participating in bar activities.

AV® rated: Attorney Heiser is proud to have received an **AV® rating* from Martindale-Hubbell®**, the country's preeminent lawyer rating service. An AV rating is a significant accomplishment—a testament to the fact that a lawyer's peers rank him at the highest level of professional excellence. A lawyer must be admitted to the bar for 10 years or more to receive an AV rating. His AV rating is based on peer reviews by members of the Bar and Judiciary. That means that the lawyers and judges with whom he has worked closely feel that he is among the best in the business not only for his legal skills, but also for his honesty, integrity and ethics.

Author: Retirement Plan Distributions: The Rules (Boulder Estate Planning Council presentation, 2/21/06); **Co-author:** Estate Planning in Tennessee (Lorman Education Services, 2000); Key Issues in Estate Planning and Probate (National Business Institute, 2000); Sophisticated Estate Planning Strategies for the Advanced Practitioner in Tennessee (National Business Institute, 1998), Advanced Estate Planning Techniques in Tennessee (National Business Institute, 1997), Family Limited Partnerships in Tennessee (National Business Institute, 1996), Living Trusts and Other Estate Planning Alternatives in Tennessee (National Business Institute, 1995), Estate Planning for the Elder and Disabled Client (Nashville Bar Association, 1994).

www.MedicaidSecrets.com/blog
Explore attorney Heiser's *Elder Law Corner!* This diary of elder law and estate planning topics will be of great interest to readers of *Medicaid Secrets*. Submit questions or suggestions for additional topics by registering on the blog page.

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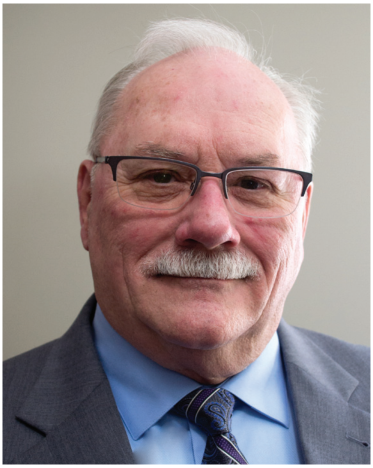

Ron Johnson and **Jim Seifrid**, the sponsors of this booklet and the Chief Stewards of Heritage Estate Plans and its sister company, Cornerstone Estate Plans LLC, operate the leading-edge membership associations in estate planning and asset protection. With roots dating from 1987, they have spent the last 30-plus years assisting well over 10,000 families protect and preserve their hard-earned assets for both their own enjoyment and also the enjoyment of their loved ones in the future. In a nutshell, Heritage and Cornerstone market peace of mind and sleep-well insurance.

Ron and **Jim** know through experience that even a well drafted estate plan (a will or revocable living trust) written to preserve and protect your financial plan will do you no good if it hasn't addressed the question:

"What plan do you have in place to preserve and protect your assets in the event of a long-term illness or nursing home stay?"

This booklet will put you on the path to a solid, well-thought-out answer to this question.

THANK YOU for taking some of your valuable time to explore and research critical information on safeguarding your assets from the devastating expense of a long-term health issue through estate planning with trusts; specifically, through the use of the Heritage/Cornerstone SafeGuard Trust.

We believe you will find that it is time well spent.

GOOD READING!

INTRODUCTION

Heritage Estate Plans and its sister company, Cornerstone Estate Plans LLC, are unique in that they are operated as membership associations. Why is this an advantage for you? Because we believe that our approach to estate planning, through your membership, is the most cost-effective way of providing service for the protection and preservation of your home and assets. The estate planning process entails many steps from general education, to questions answered, to completed documents, but only two of those steps require the assistance of an attorney. The concept of the membership association, then, is basic. For a nominal membership fee, you may use the benefits of your membership to complete most of the estate planning process for free and then use our "preferred" Attorneys only for legal advice to review and draft the documents. This process avoids most of the billable hours you would have paid had you used a law firm to create your estate plan from start to finish.

The selection, drafting and execution of your estate plan documents, however, are just the beginning of your membership advantages.

WHAT SETS US APART?

- We educate and assist our members about estate planning and how our plans will work for their unique situation, needs and wishes.
- We assist our members with the funding/retitling of their assets into the trust.
- We have no billable hours.
- Our members receive quarterly newsletters to keep them current on any law changes, etc.
- Our members receive free changes to their trust document for life.
- Our members receive free annual reviews of their estate plan.
- Probably the most important benefit to our members is that we assist our members' loved ones with the settling of their estate at their passing.
- Our members have peace of mind knowing that we are always there, at no charge, to give them ongoing service and support.

With a Heritage and Cornerstone membership, our members have an estate planning advocate in their corner both now and in the future. And, after all, isn't that what we all want and need?

Heritage and Cornerstone are proud to sponsor this special edition booklet written by Attorney K. Gabriel Heiser. Attorney Heiser's knowledge and expertise in the field of trusts and elder law make him eminently qualified to have drafted the SafeGuard Trust (irrevocable income-only trust) described in this booklet for the Heritage and Cornerstone members. Because this SafeGuard Trust was drafted by Attorney Heiser according to the US government trust guidelines as put forth in Title 19 of the Federal Social Security Act, it is legal and "works" under the federal statutes and regulations currently in effect to protect and preserve your home and assets from all creditors. Why is this important to you? Because, once the SafeGuard Trust has been executed and properly funded, any asset held within this trust, after the five-year look-back period, will not be counted or available, regardless of its worth, when applying for long-term illness or nursing home assistance through the government benefits program called Medicaid. Medicaid, when first enacted in 1964, was a program predominately for the poor and indigent. However, since the Catastrophic Care Act of 1988 and the OBRA Act in 1993, Medicaid has now become as stated by Attorney Heiser, "the long-term care plan for middle class America" for all who qualify. How do you qualify? That is what this booklet is all about.

Heritage Estate Plans is an accredited member of the Greater Chicagoland BBB with an A+ rating.

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Is Medicaid Planning Ethical?

Some people simply do not like the fact that there are attorneys who specialize in advising clients how to save their money and qualify for Medicaid coverage sooner. Their theory is that Medicaid is a "welfare" program for the poor, broke, and destitute, and was not designed as a way for middle class parents to pass their money on to their children at taxpayer expense.

My answer to this is as follows:

> John Jones lives next door to Sam Smith. Both of these fine fellows are age 75 and have about $100,000 in the bank and a home that is paid off. John has a friend named Joe who lives across town in an apartment, who used to have some savings but who squandered it on drink and gambling.
>
> John has a heart attack and is rushed to the hospital. Thank goodness he survives, but the operation costs $80,000. Lucky for him he's covered by Medicare, so he arrives home with his life savings intact. Upon his death, his $100,000 and his home pass to his children, under his will.
>
> Meanwhile, Sam has a stroke and has to be moved to a nursing home. Since the nursing home costs $8,000 a month, Sam's life savings are gone in about a year. At that point, Sam qualifies for Medicaid, which pays his nursing home bills. He continues to reside in the nursing home for two more years, and upon his death the state has spent another $200,000 on his care. Under federal law, the state must be repaid at Sam's death, and since the only asset in his name is his house, it has to be sold to repay the state, leaving his heirs almost nothing.
>
> As for Joe, his drinking takes its toll, and he also winds up in a nursing home. Since he is broke, he immediately qualifies for Medicaid, which pays all his bills. Upon his death, the state cannot be repaid since Joe leaves no estate.

So, in essence, the government is content to pay all of John's hospital bills but wants Sam to first impoverish himself and then they take his house at his death, to pay for his nursing home bills. Meanwhile, Joe is rewarded for his profligate lifestyle by getting a free ride from the government; his family does not have to chip in one penny for his care.

Oh—there's one more guy we need to meet: Bob, who also managed to save up $100,000 and pay off his house, but who was a little more thoughtful than Sam and who hired an elder law attorney to give him advice. That lawyer was aware of all the provisions of the Medicaid rules and regulations, and advised Bob to retitle his home and assets into an Irrevocable Income-Only Trust (IIOT), so that by the time Bob entered a nursing home, his assets were protected. Thus, Bob received the same care as Sam, but his assets were passed to his family and did not have to be spent on nursing home bills.

Is Sam, who managed to build up a small amount of savings, more ethical than Joe, who squandered his money and then had the government pay for his care? Is Sam more ethical than Bob, who simply followed the rules and regulations enacted by the state and federal government, and managed to protect his life savings and house? And how does that differ from the guy in the Lexus who pays top dollar to the Big Four accounting firm for clever tax planning, setting up offshore corporations so his business can legally avoid paying millions in income taxes? Legal, yes. Ethical? I leave that to you. But in any event, is it any more ethical than Medicaid planning?

As the great Judge Learned Hand famously said in the case of *Helvering v. Gregory* (1934),

> *"Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes. . . . Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."*

The United States Supreme Court reinforced this sentiment in affirming the above ruling:

> *"The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."*

No one says you have to take advantage of every possible available legal planning technique if you don't want to. You can also decide not to claim, say, a charitable deduction that is legally available to you on your Form 1040 and pay more income tax than you are required to do. **But it is certainly not unethical simply to avail yourself of the laws as they were enacted by the government in order to minimize your expenditures on nursing home care, and pass those savings on to your children.** This book will show you exactly how you can do that.

Introduction

There are many types of trusts that can be useful for Medicaid planning, but also some types of trusts that will cause assets otherwise exempt for Medicaid purposes to become countable. Thus, it is important to understand how trusts work and which types of trusts are best for your own personal situation.

Basic Terms and Concepts

A "trust" is a legal arrangement where one person (called the "trustee") holds and manages property for the benefit of someone else (the "beneficiary"). The terms of the trust document control what the trustee may do with the trust property. It will set forth specific instructions for how the property can be invested as well as who can receive distributions from the trust and under what circumstances.

Trust "property" can be any type of asset that can be titled in the name of a trust, such as cash, CDs, stocks, or real estate. The property in the trust is called the "principal" of the trust. Any interest, dividends or other income generated by the trust property is called the trust "income."

You can actually wear more than one hat: you can be the creator of the trust (called the grantor, trustor, or settlor of the trust), the trustee, *and* the beneficiary!

There are two basic types of trusts—revocable and irrevocable—and the Medicaid rules that apply to trusts differ depending on which type you create. Let's take a look at these two types of trusts.

Revocable Trusts

A "revocable" trust is one that can be changed or revoked by the creator of the trust, at any time. A revocable trust is what is commonly referred to as a "living trust." Such trusts are widely promoted in seminars as offering a tremendous number of benefits over a will. However, as a general rule, revocable trusts are not recommended for Medicaid planning purposes.

All Trust Assets Countable

If a Medicaid applicant (or spouse) has the power to revoke a trust, then *all* the assets titled in the name of that trust will be countable for purposes of determining the eligibility of the applicant, other than normally excluded assets (except for the home of an institutionalized individual). For example, if you transferred your car into the name of the trust, the car, which is normally excluded if owned in your own name, would now be countable. This applies to your home, too. Although your home is normally an excluded asset, if the home is deeded into the name of your revocable trust, it loses its exclusion and will now be a countable asset! If this is your situation, you will need to deed the house out of the trust name and put it back into your name (or your spouse's name, if you are married) before you apply for Medicaid. (For the one exception, see *Converting Non-Countable Assets to Countable*.)

Transfers To and From

There is never a penalty for transferring assets from your name into the name of your revocable trust. But should you make a distribution from the trust to a beneficiary of the trust, it's treated the same as if you made a gift of those same assets yourself, directly, i.e., in most cases subject to a penalty and the five-year lookback period.

Example:

Joe transfers $100,000 into a revocable living trust. He withdraws $5,000 a month later to pay some bills, and a month after that he writes a $20,000 check from the trust to his daughter, to help her with a down payment on a house.

RESULT: There is no penalty period imposed upon Joe's initial transfer of $100,000 into the trust, because he can revoke the trust at any time and get it all back. Also, should he apply for Medicaid, all of the assets in the trust will be countable as his own money, just as if he had not placed them in the name of the trust. This is true regardless of when he established the trust.

The gift to his daughter will be a disqualifying transfer subject to a five-year lookback period. That means that if Joe applies for Medicaid within five years from the date he wrote the check, then assuming the state penalty divisor is $5,000, such gift will cause a four-month penalty period. If he wrote her the check more than five years ago, the gift is outside the lookback period and cannot count against him. If he gave her the check within five years of his applying for Medicaid, the penalty will run from the day he applies for Medicaid (assuming he would have otherwise qualified).

Revocable trusts can be great for estate planning purposes, by avoiding probate, permitting a consolidated management of your assets in the event you become disabled, ensuring privacy of your estate plan, etc. But they are rarely used for Medicaid planning purposes for an *unmarried* individual, for the reasons discussed above. Be careful if anyone suggests to you that a "living trust" can protect you from Medicaid claims and hasten your eligibility—remember that all assets titled in the name of a living trust are countable assets for purposes of Medicaid eligibility.

On the other hand, there can be *some* benefit for a married Medicaid applicant, if the Community Spouse can transfer all of the Community Spouse's assets into a revocable trust and—in some states—eliminate the right of the nursing home spouse to force a distribution from the estate of the Community Spouse should the Community Spouse predecease the nursing home spouse. This will be discussed in greater detail below.

Irrevocable Trusts

An "irrevocable" trust is one that cannot be changed or revoked by the creator of the trust. Irrevocable trusts can be very useful for Medicaid planning purposes.

Transfers To and From

If you transfer an asset into the name of an irrevocable trust, is it considered a gift? The test is whether any portion of the trust may be distributed back to you for any reason under any circumstances. If so, then that portion of the trust is treated as an available asset to you, i.e., the same as if you had put the asset into a revocable trust. If there are *no* circumstances in which the assets you put into the trust can be distributed back to you, then your transferring those assets into the trust is a gift. This would be calculated the same way as a gift to an individual. For example, if you transfer $100,000 into the name of an irrevocable trust and the terms of the trust state that only $10,000 can ever be distributed back to you *if* you had serious medical problems, then (i) $10,000 (i.e., 10%) of the trust is counted as an available asset to you for Medicaid purposes, and (ii) the balance of $90,000 is deemed a gift from you, subject to a penalty and the five-year lookback period.

If the trust states that distributions may be made back to you but also may be made to someone *other than you*, such as your children, then any distribution out of the trust to this other beneficiary is deemed a gift *from* you (and therefore subject to a penalty and the five-year lookback period).

If the trust does not permit distributions of principal back to you under any circumstances, then your transfer of assets to such a trust is a gift, as explained above. In addition, any distributions from such a trust *to someone other than you* are ignored, because the penalty was imposed when you initially transferred the property *into* the trust. They can't penalize you twice for transferring the same property!

If the trust states that the income *or* the principal of the trust can be distributed back to you, any distribution from the trust to you is treated as income to you (for Medicaid purposes; different rules apply for income tax purposes).

If income *can* be distributed to you, in the trustee's discretion, but is withheld for any reason, that income is treated as a resource of yours. If you are already covered by Medicaid, be sure that any such income does not accumulate, possibly putting you over the $2,000 limit. The way to avoid that is for the trust to distribute all such income to you (or to your spouse, if any) so it does not accumulate.

Planning with Irrevocable Trusts

Once your transfer to the trust is considered a gift, it is no longer a countable asset of yours. That is why irrevocable trusts can be excellent long-term planning vehicles: once the lookback period has expired, the trust is ignored. So if you transfer all your assets into the right kind of irrevocable trust and wait out the five-year lookback period, the assets in the name of the trust, no matter their value, will not count against you when you apply for Medicaid. (See Lookback Period.)

Example:

For example, assume you are age 65 and believe that you are in pretty good health with little likelihood of needing nursing home care for many years. However, you are concerned that if you did have to go to a nursing home someday, the costs would deplete your estate. Instead, you'd like to leave your estate to your children, if at all possible. Accordingly, you go to your elder law attorney to create an irrevocable trust, and you transfer $300,000 (or a parcel of real estate—even your home) into the trust.

After five years have passed from the date you transferred the money or property into the trust, that transfer will be outside the five-year lookback period and thus cannot affect your Medicaid eligibility. You may even be able to serve as trustee of your own trust (depending on the state rules), so you can continue to manage and control the trust assets for the rest of your life. You can include a provision allowing discretionary distributions to your children and grandchildren out of the trust, giving you the power to make gifts to them at any time in any amount. If it is your home that you put into the trust, you can reserve the right to live in the house for the rest of your life. If you ever need to move, the trustee can always sell the house and purchase another house, or a condo, and if there are extra proceeds from the sale of the house, they would remain as part of the trust, protected from Medicaid claims.

Let's look at a couple of examples showing the effect of transfers to and from irrevocable trusts.

Example 1:
Martha established a revocable trust a few years ago, which is now worth $80,000. Upon thinking about her future, she decides to make the trust irrevocable for asset protection purposes. She retains the right to all the trust income, but in no circumstance may the trustee distribute any of the underlying trust principal to her. On the date she makes the trust irrevocable, she is treated as having made a gift of $80,000 to the other trust beneficiaries. Should Martha apply for Medicaid within five years of that date, she will be faced with a penalty period of $80,000 divided by the state penalty period divisor. So if the divisor is $5,000, then the penalty period will be 16 months. Again, the penalty will not start to run until the day she applies for Medicaid.

Example 2:
Sam creates an irrevocable trust that says that no distributions of trust property can be made back to him unless he is in a nursing home. He transfers $150,000 into the trust. Because there are still some circumstances under which the trust property can be distributed back to him, even though he's not in a nursing home now, this transfer is not considered a gift. A year later, he writes a $10,000 check from the trust to his grandson, as a college graduation gift. The gift to his grandson will be a disqualifying transfer subject to a five-year lookback period. Should Sam apply for Medicaid within five years of that date, then assuming the state penalty divisor is $5,000, such gift will cause a two-month penalty period to run from the day he applies for Medicaid.

(NOTE: It may be possible for Sam to argue that the gift to his grandson was made exclusively for a purpose other than to qualify for Medicaid, which would eliminate the penalty.)

Income-Only Trusts (“SafeGuard Trust”)

What if you needed to receive income from the trust assets to pay your living expenses, but still wanted to insulate the trust assets should you ever need to apply for Medicaid? In that case, what you should consider is an income-only trust. Let’s take a look at how that works, now.

If you create an irrevocable trust and retain no rights to receive any distributions from this trust, you are deemed to have made a gift of the entire amount of assets you transferred into the trust. Since you have no access to the trust property, no part of the trust property is countable as an available asset of yours.

But what if your trust document permits the trustee to distribute trust *income* to you? So long as you can only receive the *income*—and the trustee can never distribute any portion of the trust *principal* to you—then the income is countable as your income, under the income rules discussed above, but the principal of the trust is still not countable as your property. So if you set up such a trust and transfer some part or all of your assets into the trust, once the five-year lookback period has passed the trust property will be ignored when the Medicaid eligibility department assesses your application.

Example:
Your attorney sets up an irrevocable income-only trust for you. You transfer $50,000 in cash into the trust. You have no right ever to get a distribution of any part of that $50,000, but the trustee does have the authority to distribute the income earned on that $50,000 back to you every quarter.

The full amount transferred into the trust—$50,000—is treated as a gift, just as if you gave it to a child of yours. As such, there is a penalty based on dividing the amount of the gift by your state “penalty divisor” figure. Assume the divisor is $5,000. Thus, $50,000 divided by $5,000 is 10, so that means there is a penalty period of 10 months. If you apply for Medicaid within five years of your transfer to the trust, this penalty period will have to be dealt with. Once the five-year period has passed, however, the gift will be ignored when you apply for Medicaid, and the assets inside the trust, no matter what their value is at that time, will also be ignored.

Dealing with Trust Income

Once you are in a nursing home, if you retained the right to all trust income, your trustee can change investments so as to minimize the amount of income earned by the trust and thus distributable to you. The trustee cannot merely *withhold* part or all of the trust income from you; undistributed but earned trust income will be considered an available resource, possibly causing you to lose your Medicaid coverage! But reducing income distributions to you is a good idea, because every such distribution must go directly to the nursing home, and once you are on Medicaid such distributions will serve only to reduce the amount that Medicaid would otherwise pay to the nursing home on your behalf. Your care will not change if the nursing home gets more of its fee from the state under the Medicaid program and less from your trust; the nurses or aides on your floor do not know if your bill is paid by you or by Medicaid.

It is also possible to draft the trust so that if you are in the nursing home and no longer require trust income, the trustee can distribute some part or all of the trust principal to your children (for example). This obviously reduces or eliminates trust income distributions to you, and it also eliminates the state's ability to recover against the trust following your death, in those states with an expanded definition of "estate".

Should You Retain Income Payments?

Retention of the right to receive trust income can cause numerous problems, such as the following:

- The income must go to the nursing home once you are in a nursing home (but see prior section regarding ways to minimize income)
- Some states consider the entire trust in which you have retained the income as a countable asset
- Some states may count the income interest under their expanded estate recovery rules following your death
- It can cause the entire trust to be a countable asset under VA Pension rules
- It can increase the size of your "estate" for elective share purposes in certain states, resulting in more of your property passing to your surviving spouse, who may be in a nursing home (See *Elective Share Problem*.)

- There are other ways to make the trust income taxable to you, even if you don't receive the income
- There are other ways to get the trust property back to you, such as a "back door" provision permitting distributions to children

Thus, you have to balance the possible disadvantages depending on the rules of your state against the desire to retain all income payments from your trust. Most people prefer retaining the income payments, if it is possible to do so, rather than relying on having to ask their children for money! Be sure to discuss these issues with the attorney drafting your trust, so you feel comfortable with the ultimate decision.

Due-on-Sale Problem

If you transfer your house into an irrevocable trust, you must be aware of the "due-on-sale" clause in all mortgages: this states that if you transfer your house during the term of the mortgage loan, the loan will immediately become due in full! Clearly you want to avoid that. Luckily, there is a provision in the federal law that states that if the house being transferred is your residence and it's being transferred into an irrevocable trust in which you are a beneficiary and retain your right to live in the house, then the due-on-sale clause may not be invoked. Thus, it is important that the trust (or a separate occupancy agreement) explicitly state that you have the right to occupy the residence.

Trigger Trust option

As a way to deal with the "wasted income" problem discussed above, some trust documents state that if you are in a nursing home and receiving Medicaid, no income may be distributed to you. This is called a "trigger trust." Under former law, this was permitted but seems to have little utility, now. During the period you are entitled to receive the income, even if it is discretionary with the trustee, undistributed but earned trust income will be considered an available resource and will count against you, even if you cannot demand a distribution. And if at some future time after the trust is established, your right to receive the income is terminated, you may be deemed to have made a gift on the termination date (of the present value of your income interest), causing a penalty period. In addition, some states have banned this option as being "against public policy."

Using Two Irrevocable Trusts

If you own a house and are considering using an irrevocable trust to protect your assets, consider the benefits of establishing *two* trusts (these can be two separate trusts or two sub-trusts within one trust document).

The first trust will hold only your house and will be a "grantor trust" meaning that all the income will be taxable to you. Of course, since this trust will only hold the house, it won't generate any income. But the advantage of it being classified as a grantor trust is that should the house be sold during your lifetime, the trust can take advantage of the capital gains exclusion normally only available to persons, not trusts. This exclusion enables a person (and a grantor trust) to exclude up to $250,000 in capital gains upon the sale of the house if you are unmarried and up to $500,000 if you are married.

The second trust will hold your assets other than the house, such as cash or other investment assets. It will be set up so that it is *not* a grantor trust, so that if the trust earns income it won't be taxed to you even if you never get a distribution of the income during the year or the trust is written so that you are not an income beneficiary at all (important for VA pension planning).

Should your house be sold and a replacement not purchased, the trustee should be permitted to distribute the proceeds to the other (nongrantor) trust or to terminate the provision that made it a grantor trust (of course, this requires that the trust have been drafted to permit this).

If your income tax situation is such that you pay *no* tax (e.g., you only have Social Security), then there really would be no advantage of this second trust and you can just use a single grantor trust for the house and cash.

Irrevocable Trusts vs. Outright Gifts

What if you have $100,000 of excess assets and must reduce your assets before you can qualify for Medicaid? What if you don't need nursing home care now, but may in, say, five years or more? Should you just give your children the money? Or transfer it into an irrevocable trust?

Here are some advantages of setting up and funding an irrevocable trust, as described above, vs. making the outright gift:

- the trust protects your assets while you are living, both from your children's creditors as well as your own;
- the trust permits you to serve as trustee, with one or more children named as successor trustees, so that you can continue to manage and invest the assets as you see fit, so long as you are able to do so (however, if possible, it is better if you do not act as your own trustee, since some states view that as "controlling" the trust, causing it to be a countable resource);
- the trust assets will not count against you when and if you ever need to apply for Medicaid, should you ever need nursing home care;
- the state cannot go after the trust assets after you die, under their "estate recovery" program, whereby they seek to be repaid for every dollar they spent on you while you were in the nursing home (it is possible that if your state has an expanded estate recovery statute it could try to recover against an income-only trust, so this needs to be checked before you set one up);
- the trust protects the assets from attack by a child's creditors or spouse (should they ever get divorced);
- the trust continues to allow you to control the ultimate disposition of the assets following your death, by retaining what is called a "testamentary limited power of appointment";
- the trust does not increase the Medicaid "lookback period" as compared to an outright gift (this used to be one reason people preferred outright gifts prior to the law being changed in February 2006);
- the trust can permit income to be distributed to you for life;
- income taxes will usually be less, since the income will be taxed to you and not your children;
- if your home is transferred into the trust name, the capital gains exclusion will still be available, should it be sold during your lifetime (not so if it were instead gifted to the children);
- it can permit "back door" distributions to family members should that be necessary down the road; and
- it permits a step-up in basis of gifted assets, saving income taxes for your children.

As you can see, there are many benefits to the trust compared to an outright gift to children. What are the drawbacks?

- A trust costs money to prepare;
- it takes time to understand how it works;
- a new, separate bank account will have to be opened up in the name of the trust;
- a federal tax i.d. number may need to be obtained for the trust (although this is now easily done online);
- additional paperwork is involved for trust accounting; and
- a separate income tax return may need to be filed each year (Federal Form (1041).

Self-Settled Trusts

If you are under age 65 and considered disabled, a trust can be established for your benefit with your own assets that will not be counted for Medicaid eligibility purposes. In addition, the transfer of your assets into such a trust will not cause the imposition of a penalty. The trust may be established by you or by a parent, grandparent, legal guardian or a court, on your behalf and for your sole benefit. In order to qualify, the trust must contain a "payback" provision that requires the state to be reimbursed following your death for all the Medicaid payments it made on your behalf during your lifetime.

Because the rules for such a trust are found in the federal statutes at 42 U.S.C. section 1396p(d)(4)(A), it is also known as a "(d)(4)(A)" trust.

Why would you do this? First of all, such a trust can *supplement* what the Medicaid program pays for, improving your lifestyle. For a list of typical items such a "supplemental needs" trust can pay for, see the list at the end of this chapter.

Second, by qualifying for Medicaid coverage, your expenses will be paid for at the reduced "Medicaid reimbursement rate," so even if your assets are ultimately used to reimburse the state, it will leave more of your assets to pass on to your family members (assuming the trust assets are not totally depleted by the reimbursement).

Pooled Trusts

A "pooled trust" is a trust fund set up by a non-profit organization within your state that holds funds of disabled individuals to be used to supplement their living expenses. The contributions of each disabled person are accounted for separately, but the assets of all contributors are invested and managed as a single "pooled" fund, hence the name.

Although it is an irrevocable trust, federal law has carved out an exception for pooled trusts from the normal trust rules discussed above. Accordingly, the transfer of assets *into* the trust is not considered a penalty-causing gift, and the assets *within* the trust are not counted as owned by the disabled person when that person applies for Medicaid. If the potential Medicaid applicant is over age 65, however, some states will treat the transfer into the pooled trust as a disqualifying transfer. Thus, be sure to check your state rules before considering this option!

Because the rules for such a trust are found in the federal statutes at 42 U.S.C. section 1396p(d)(4)(C), it is also known as a "(d)(4)(C)" trust.

The important point is that the contribution of the disabled individual, while excluded for Medicaid purposes, can be used to pay for items that Medicaid does not pay for. For a list of typical items such a "supplemental needs" trust can pay for, see the list at the end of this chapter.

Upon the Contributor's Death

It is important to note that upon the death of the disabled individual who contributed funds to the pooled trust, any remaining funds in that person's separate account must either be retained in the pooled trust for the benefit of other disabled persons or used to pay back the state for any Medicaid outlays it made on behalf of the disabled individual during his or her lifetime. The balance of the account, if any, may then be paid to a named beneficiary (such as a family member) or left in the pooled trust to benefit others. Whether the full amount remaining at the contributor's death must be retained in the pooled trust, or only a certain percentage, depends on your state regulations and the trust documents. You can easily find this out by contacting the administrators of the pooled trust program in your state; you can find their contact information by doing an internet search under "pooled trust Florida" or whatever state you're in.

Reasons for Using Pooled Trusts

You might be thinking, if upon your family member's death all the remaining money in your family member's pooled trust account must either go to the state or remain inside the pooled trust, why do it? The reason is that without transferring the excess assets into a pooled trust, your disabled family member may have to spend all of his or her money on nursing home care until it's gone, and therefore have no money for supplemental care (see *Supplemental Needs: List*). With the pooled trust, the individual would qualify for Medicaid immediately, and yet the assets are still available to be spent for the individual's supplemental care for the remainder of his or her life.

In addition, because a non-profit organization is managing the pooled trust and making appropriate distributions to each beneficiary, there is no need to find an individual or corporate trustee for the disabled individual's funds. Indeed, if the money involved is fairly modest, e.g., $50,000, it would be disproportionately costly to hire a trustee, but the money would still cause the disabled person to be disqualified from government benefits unless something is done with it. Finally, there is satisfaction in knowing that any amount of the trust account that remains at the death of your disabled family member will contribute to the pooled trust's support of other disabled and elderly individuals. Hence, the pooled trust could be the perfect solution; it is certainly a viable option to be considered when doing your Medicaid planning.

Trusts Created by Someone Else

A trust created by someone other than you or your spouse is known as a "third-party-created trust" or simply a "third-party trust." Different rules apply to these kinds of trusts than to a "self-created" trust that you set up for your own benefit. Here are the rules for third-party-created trusts.

If the trustee of a third-party-created trust has an obligation to pay for your "support" or "medical care" or similar terms, then the trust assets will be countable as your assets when you apply for Medicaid. The theory is that the trustee has a legal obligation to pay for your nursing home bills out of the trust property before Medicaid will pay for you. In such a case, all of the trust assets will have to be "spent down" to the level required before you will be eligible for Medicaid coverage.

"Supplemental Needs" limitations

However, if the trustee is limited in paying for your care such that the trust property can only be used to "supplement" but not "supplant" benefits otherwise available to you, then such a trust generally will not be a countable asset for Medicaid eligibility purposes. The theory is that if the trustee is barred from making distributions that would reduce or replace what Medicaid already pays for, the trust assets are not considered to be "available" to you—and therefore are non-countable—for Medicaid eligibility purposes.

In many states, if the trustee is given broad "sole and absolute discretion" whether or not to distribute anything to you, then the trust assets are not countable for Medicaid purposes. Since you have no legal right to force the trustee to distribute anything to you, the assets cannot be counted as available to you. On the other hand, such a purely discretionary trust is risky because the beneficiary or trustee may move to another state, causing the new state's laws to apply. Indeed, there are cases in several states that have held that the trustee of a purely discretionary trust is required to exercise its discretion to pay for support in some circumstances (causing the trust assets to be countable for Medicaid purposes), and there are arguments that purely discretionary trusts are particularly vulnerable in states that have adopted the Uniform Trust Code. Thus, to be on the safe side, you may want to include the limitations discussed above.

One big difference in such trusts is that they do not need to pay back the state upon the death of the beneficiary for any Medicaid benefits it paid out while the beneficiary was living.

Because these types of trusts state that they are only to "supplement" benefits otherwise available to—or pay for the "special needs" of—a disabled beneficiary, they have become known among attorneys as "supplemental needs trusts" or "special needs trusts."

You'll definitely need the assistance of a skilled elder law attorney if you find that you wish to set up a trust for the benefit of someone other than yourself who is planning on applying for—or who is already receiving—Medicaid or other governmental assistance.

Trusts Created Within a Spouse's Will

Under federal law, if Spouse A creates a trust for the benefit of Spouse B, the trust is nonetheless treated as if created by Spouse B for his or her own benefit. As such, the trust is treated as a self-settled trust, described above, with the result that in most cases all of the trust assets will be considered to be available to Spouse B.

One exception to the above rule is that if a trust is created *within the will* of a deceased spouse for the benefit of the surviving spouse, the trust assets are *not* countable as assets of the surviving spouse, assuming certain requirements are met. Basically, such a trust will be treated as a "third-party-created" trust, described above, and should therefore include supplemental needs language.

Example:
Marsha goes to her attorney to draw up a will for her that leaves all of her assets in a trust for the benefit of her husband, Louis, who is residing in a nursing home. The trust states that distributions can only be made—in the discretion of the trustee—for the supplemental needs of Louis, and no distributions can be made that would reduce any government benefits he would otherwise be entitled to receive. Upon Marsha's death, her assets flow into this trust and are held for the benefit of Louis without causing him to be disqualified from Medicaid. (See, however, *Elective Share Problem*.)

This type of trust is called by lawyers a "testamentary" trust because it is created within a Last Will and Testament, an old-fashioned expression for a will.

Children-Funded Trust

Following a gift to the children from a parent, the children can make equal contributions of the money the parent gave them into a single trust. One or more children can act as trustee although having an independent (i.e., non-family member) trustee will both better insulate the money from creditors of the children and hopefully avoid family squabbles on use of the funds. The trust can name the parent as beneficiary, to cover any of the parent's "supplemental needs" (i.e., expenses *not* paid for by Medicaid, once the parent is eligible). This guarantees that the money will be available for the parent, should he or she ever need it, since it is now out of the children's names completely. Also, if a child is ever sued, divorced, or goes bankrupt, the share of the money the child received from the parent is protected; since the child is not a beneficiary of the trust, it is not a "self-settled" trust open to creditor attachment. The children's descendants can also be discretionary beneficiaries, if the children want to include the ability to distribute to them.

Alternatively, the trust can allow distributions to be made only back to the children, who could then turn around and use it for the parent's benefit, similar to the joint account arrangement discussed below in *Post-Gift Transfers by Children*. The advantage to this alternative is that it makes it much harder for the state to claim that the trust was "really" established by and for the parent, causing inclusion of the trust property in the parent's countable assets (although this does not offer the creditor protection of the first option).

It is important that the children's funding a trust for the parent is viewed as an independent act of theirs and not as part of a coordinated plan that the parent and the children agreed to in advance of the parent's gifts to them. Otherwise, the state Medicaid authorities can argue that in essence, *the parent* set up the trust *for his or her own benefit*, using the parent's own money, and therefore all the assets in the trust are now countable under the self-funded trust rules. Accordingly, if the children are going to set up such a trust, they should not hire the same attorney who assisted the parent with his or her Medicaid planning. The children should also allow a reasonable amount of time to pass before they create and fund this trust. What's "reasonable"? Unfortunately, there is no hard and fast rule; clearly a week is too soon and five years longer than necessary, so pick somewhere in between! The attorney the children hire is in the best position to advise them about this issue.

Supplemental Needs: List

"Supplemental needs" are those needs of a nursing home resident or other disabled individual that are not covered by Medicaid or Medicare, yet are important in making life better for the individual. Here is only a partial list of such items:

- supplemental nursing or geriatric care
- alternative medical therapies
- physician specialists if not covered by Medicaid
- dental work not covered by Medicaid, including anesthesia
- massage sessions
- haircuts and salon services
- over-the-counter medications (including vitamins and herbs, etc.)
- non-food grocery items
- personal assistance not covered by Medicaid
- taxi cab rides and other travel expenses to visit family members
- a specially equipped auto or van
- furniture, home furnishings
- clothing
- cell phone and service costs
- vacation trips (including a personal assistant to facilitate the trip)
- entertainment (large TV for the room, etc.)
- upgrade cost for a private room (Medicaid only pays for a semi-private room)
- attorney fees

Definitions

Community Spouse: The spouse who resides in the community, when one spouse of a married couple is in the nursing home. Also referred to as the "healthy spouse."

CSRA ("Community Spouse Resource Allowance"): The amount of countable resources permitted to be owned by the Community Spouse, in order for the Institutionalized Spouse to qualify for Medicaid. In 2015 this amount is $119,220.

Grantor: The person who creates and funds a trust.

Irrevocable Trust: A trust that may not be revoked or amended by the creator of the trust.

Living Trust: A trust that is created and operational during the lifetime of the creator. The term is usually used only to refer to a trust that is amendable and revocable by the creator. *See* **Testamentary Trust.**

Lookback Period: The period of time prior to the date of a Medicaid application during which any gifts made by the person applying for Medicaid must be counted. Current lookback periods in states that have adopted the DRA are 36 months for outright gifts made prior to February 8, 2006 and 60 months for all gifts made thereafter.

MMMNA ("The Minimum Monthly Maintenance Needs Allowance"): This is the minimum amount of income that a Community Spouse is entitled to have. If the Community Spouse has less than this amount, he or she is entitled to shift from the Institutionalized Spouse's income that amount of income necessary to increase the Community Spouse's income to the MMMNA.The MMMNA is set by the federal government and changes annually. The MMMNA for the first half of 2015 was $1,966. This figure changes on July 1 of each year.

Maximum MMMNA: In certain cases, the **Community Spouse** may petition to increase his or her **MMMNA**, e.g., if the Community Spouse has high shelter related costs or other unusual expenses, such as very high personal medical costs. If such costs are approved, the MMMNA can be increased to as high as $2,981 (2015 figure).

Penalty Divisor: The dollar number that is divided into the amount of a gift in order to determine the number of months of the **penalty period.** The divisor number varies from state to state and is typically updated annually to reflect the average monthly cost of a nursing home in the particular state (or region of the state, in some cases).

Penalty Period: The period of time during which an applicant for Medicaid coverage will be disqualified from such coverage, based on the amount of gifts made within the **lookback period.** *See* **Penalty Divisor.**

Pooled Trust: A state-chartered charitable organization specifically created to hold contributions of many disabled individuals, for the **supplemental needs** of each disabled individual. Each contribution is maintained in a separate account for the lifetime of the individual.

Revocable Trust: A trust that may be revoked and amended at any time by the creator of the trust.

Self-Settled Trust: A trust funded with the assets of (and typically also created by) an individual for such individual's own benefit. *See* **Third-Party-Created Trust.**

Settlor: *See* **Grantor.**

Special Needs Trust: A trust that is specifically created to distribute its assets for the benefit of a disabled individual in such a way that the trust will not disqualify the individual from receiving various government benefits. For these purposes, "special needs" are defined as those benefits and services that supplement but do not supplant, replace, or reduce otherwise available government benefits. Also known as a **Supplemental Needs Trust.**

Testamentary Trust: A trust created within the provisions of a will. Thus, it only becomes effective following the death of the creator of the will.

Third-Party-Created Trust: A trust created and funded by someone other than the beneficiary or his or her spouse.

Trust: A form of divided ownership: one person (the **trustee**) takes title to an asset for the benefit of another person (the beneficiary). It is essentially an agreement between the creator of the trust (known as the **grantor, trustor,** or **settlor**) and the trustee, who oversees the trust property. The terms of the agreement are set forth in the trust document itself. A trust can be a free-standing, separate document (such as a **revocable trust** or **living trust** or **inter vivos trust**) or contained within the terms of a will (a **testamentary trust**).

Trustee: The individual or entity who manages and invests the trust assets and also determines the amount and frequency of distributions to the person or persons who benefit from such distributions (the beneficiaries of the trust). Many times family members serve as trustees for other family members, or a bank or trust company may be employed to do so.

For more information on this topic please contact the Heritage/Cornerstone representative below:

WHAT WE KNOW FOR SURE!

- 7 out of 10 of all of us will need long-term care assistance (20% at home, 50% at nursing home).
- The average nursing home stay is 2.8 years.
- The national average cost of a semi-private nursing home room is $225/day, $6750/month, or approximately $225,000/stay.
- Medicare and most insurance plans, including Medicare supplement policies do not pay for long-term care assistance.
- While long-term care insurance is available, it is expensive and due to health issues, many will not qualify.
- Long-term care insurance is limited by when coverage begins, how much it pays out per day and for how long it pays out. Most policies are woefully inadequate.
- Much information and advice given to us about estate and long-term care planning from well-intended persons (family, friends, financial planners, CPAs, and even some attorneys) is misguided and dangerously wrong.

This special edition booklet explains the one and only type of trust document drafted and approved according to US government guidelines* to protect your home and assets from the devastating expense of a long-term illness.

*Source: US Government *Program Operations Manual* for Social Security and Medicaid benefits

Cornerstone Estate Plans, Local Office

608-403-7008 or Fax 24/7 888-855-8843