

MEDICAID ASSET PROTECTION TRUST- IRREVOCABLE INCOME ONLY TRUST

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BENEFITS OF IRREVOCABLE MEDICAID TRUST

- Valuable planning technique to protect assets
- Beneficial strategy for Medicaid advance planning as well as Medicaid crisis planning
- Stream of income to the Settlor
- Principal protected from long-term care expenses
- Principal can be distributed to a third party
- Trust assets protected from creditors of Settlor

BENEFITS OF IRREVOCABLE MEDICAID TRUST CONTINUED

- Trust assets protected from creditors of remainder beneficiaries-Outright gifts not protected.
- Assets pass to family members at Settlor's death
- Settlor can retain a limited power of appointment
- Favorable income, gift, real estate & estate tax benefits
- Useful tool to minimize taxes, avoid probate and provide asset management

WIN, WIN, WIN PLANNING TECHNIQUE

DRAFTING REQUIREMENTS OF IRREVOCABLE MEDICAID TRUST

- In writing, executed by Settlor and Trustee and acknowledged by a notary public or 2 witnesses
-EPTL Section 7-1.17(a)
- Irrevocable Trust
-EPTL Section 7-1.16- A lifetime trust is irrevocable unless expressly state revocable
-Good practice to state Settlor cannot revoke
- Designation of Trustees
-Do not name the Settlor or Settlor's spouse
-Can name children or third party
-Include Trustees in planning

DRAFTING TRUST-GRANTOR TRUST STATUS AND TAX CONSIDERATIONS

- Want Grantor to be deemed the “owner” of trust’s income and principal for tax purposes
- Although trust is irrevocable, the Grantor retains some interest or control
- Personal income tax rates are more favorable than trust income tax rates
- 2014 Federal income tax rates:
 - 39.6% tax rate for individuals with income > \$406,750
 - 39.6% tax rate on Trust income over \$12,150

GRANTOR TRUST STATUS FOR INCOME TAX PURPOSES

In order to tax trust income to the Grantor at a lower tax rate, the trust must be a “Grantor Trust” for income tax purposes. IRC Sections 671-679

- Complicated Grantor Trust rules for income, gift and estate tax purposes
- Some Grantor Trust provisions are not advisable for the Medicaid Asset Protection Trust
 - IRC Section 676—Power to revoke trust
 - IRC Section 673--Reversion of trust corpus at death of Grantor
 - IRC Section 674—Power to control beneficial enjoyment of trust assets

GRANTOR TRUST STATUS FOR INCOME TAX PURPOSES

Following trust provisions will tax trust income to Grantor and work well for Irrevocable Medicaid Trust:

- IRC Section 677- All trust income payable to Grantor (Taxes income only to Grantor and not capital gains)
- IRC Section 675- Power to reacquire trust corpus and substitute property with an equivalent value (Taxes capital gains/income allocable to principal to the Grantor)
- IRC Section 674-Unrestricted power to remove Trustee or Testamentary Power of Appointment-Taxes capital gains/income allocable to principal to Grantor

GRANTOR TRUST STATUS FOR GIFT AND ESTATE TAX PURPOSES

- A transfer to an irrevocable trust is generally a completed gift—Grantor parted w/dominion & control
- For Medicaid planning purposes, typically do not want transfer to irrevocable trust to be a completed gift
- Benefits of having transfer to irrevocable trust not being deemed a completed gift:
 - No Federal gift tax return required
 - No carry-over basis in trust assets to beneficiaries
 - Stepped-up basis in trust assets at death
 - Favorable income tax treatment on sale of Trust assets including residence- IRC Section 121

GRANTOR TRUST STATUS FOR GIFT AND ESTATE TAX PURPOSES

Trust provisions that prevent a transfer to Irrevocable Medicaid Trust from being a completed gift:

- A retained Limited Power of Appointment to change beneficiaries of trust-Treas Reg Section 25.2511-2 Grantor possesses dominion & control over trust property & therefore, transfer not a completed gift

Trust provisions that include trust assets in Grantor's estate:

- IRC Section 2038-Limited Power of Appointment
- IRC Section 2036- All income to Grantor

INTERPLAY OF GRANTOR TRUST RULES AND MEDICAID ELIGIBILITY

- For Medicaid purposes, want trust assets protected & not deemed owned by the Grantor or available to pay for Grantor's LTC expenses.
- For income, gift & estate tax purposes, want Grantor to be deemed owner of trust to preserve favorable tax benefits to Grantor.
- How to draft trust to satisfy the complicated Grantor Trust rules & preserve favorable income, gift & estate tax benefits to Grantor while still protecting assets for Medicaid eligibility purposes?

DRAFTING THE IRREVOCABLE MEDICAID TRUST--TYPICAL TRUST PROVISIONS:

(1) All trust income to Grantor

-The income of the trust shall mean the actual income earned by the trust and shall not mean the unitrust amount as defined in EPTL Section 11-2.4

-Trustee shall have no power to adjust between principal & income pursuant to EPTL Section 11-2.3(b)(5)

DRAFTING THE IRREVOCABLE MEDICAID TRUST--TYPICAL TRUST PROVISIONS:

(2) No trust principal to Grantor or Grantor's spouse

-Direct that EPTL Section 7-1.6 shall not apply to prohibit invasion of principal to income beneficiary

(3) Trustees can distribute trust principal to third party

-Limit Trustees' power to distribute to themselves

-Trustee can distribute to self if sole Trustee and limited by an ascertainable standard-for HEMS

MEDICAID TRUST PROVISIONS CONTINUED

(4) At death of Grantor, trust assets pass to family members, third party or charity-same as Will

(5) Grantor retains a Limited Power of Appointment to change how trust remainder is distributed upon Grantor's death

- Can't appoint to Grantor, Grantor's estate, Grantor's creditors or creditors of Grantor's estate, or to spouse, spouse's estate, spouse's creditors or creditors of spouse's estate
- For Medicaid eligibility purposes, need to limit grantor's power of appointment to prevent trust assets from being deemed available to Grantor

MEDICAID TRUST PROVISIONS CONTINUED

(6) Provisions for a surviving spouse

- Outright to spouse
- Trust continue with same provisions, income only to spouse, principal to children
- Distribute Net Elective Share Outright to Spouse-Greater of \$50,000 or 1/3 of net estate reduced by other assets passing to spouse--EPTL Section 5-1.1-A
- Trust assets pour-over to Testamentary Trust fbo spouse so Trust income and principal can be payable to spouse until spouse could become Medicaid eligible

MEDICAID TRUST PROVISIONS CONTINUED

- (7) Power to reacquire trust corpus and substitute property of an equivalent value-IRC Section 675
- (8) Power to remove a Trustee-IRC Section 674
 - Careful to not include too broad a power to designate a new Trustee without limitations
- (9) Provisions allowing the Grantor and/or spouse to reside and use any real estate held in the Trust

REAL ESTATE AND MEDICAID INCOME ONLY TRUSTS

- The client's primary residence and retirement accounts are typically their most valuable assets
- The home is an exempt resource if spouse lives there but what if the "well spouse" dies first or there is no spouse
- Clients are frequently concerned about ability to sell home & STAR and Veterans exemptions if the home is transferred to an Irrevocable Trust

REAL ESTATE AND MEDICAID INCOME ONLY TRUSTS

IRC Section 121 is available to Grantor Trust

- The sale of home by a Grantor Trust is treated as sale by Grantor
 - Exclude up to \$250,000 of gain for single taxpayer & \$500,000 of gain for couple
- Such favorable income tax treatment is NOT available with outright gift of home to child with retained life estate
 - Sale proceeds to child subject to capital gains tax

REAL ESTATE AND IRREVOCABLE MEDICAID TRUST CONTINUED

- STAR and VETERANS Exemptions are available for real estate in trust
 - Real Property Tax forms-list transfer to Grantor Trust
 - Trust provisions-Grantor can use the real property held in trust
- Upon death of Grantor, house gets a stepped up basis to date of death value

FUNDING IRREVOCABLE MEDICAID TRUST

- Assist client and Trustees with funding Trust
- Discuss how much to transfer to Trust and which assets to put into trust
- Advance Medicaid planning versus crisis planning
- Transfer of home and other real estate
 - Sign deed on same date that trust is signed
 - Obtain real estate appraisal to document value of gift
 - Homeowner's insurance must be updated
 - Review need to update title insurance

FUNDING IRREVOCABLE MEDICAID TRUST CONTINUED

- Cash, Stocks and Bonds-call bank and broker
- Do not transfer IRAs, 401(K) plans or retirement accounts-accelerate income tax
- Certificates of Deposit and Annuities
 - Determine income tax consequences and penalties prior to transfer to trust
- Follow-up with client to confirm assets properly transferred AND trust properly administered
 - All income in fact paid out to Grantor
 - No principal paid to/for benefit of Grantor

TAXPAYER IDENTIFICATION NUMBER FOR IRREVOCABLE MEDICAID TRUST

- Does a Medicaid Income Only Trust need an EIN or can the Trust use the Grantor's SSN?
 - Many attorneys do obtain EIN for Trust
 - Bank employees and brokers expect EIN
- Form SS-4-Application for Employer Identification Number-EIN
- Apply online at www.irs-tax-id.com/

TAXPAYER IDENTIFICATION NUMBER FOR IRREVOCABLE MEDICAID TRUST

- Treas. Regs Sec 301.6109-1(a)(2) provides that a Grantor Trust (IRC Sec 671-678) that is treated as owned by a single person does NOT need to obtain an EIN if:
 - (1) The Trustee provides the Grantor's name, address and SSN to the financial institution
 - (2) The Trustee provides the Grantor with sufficient information to report trust income on personal income tax return

BENEFITS OF USING GRANTOR'S SSN FOR TRUST AND NOT A NEW EIN

- Separate Income tax returns not required for Trust if use Grantor's SSN for Trust accounts
 - Trust income reported under Grantor's SSN
 - Grantor includes all income on personal tax return
- Upon Grantor's death, then apply for EIN for trust
- Even if get EIN for Grantor trust when established, upon Grantor's death, the trust is no longer a "grantor trust" and therefore, may need new EIN

WHAT IF GRANTOR NEEDS TRUST PRINCIPAL

- Grantor moves into assisted living facility or is privately paying for home care & wants trust principal
- Need to "gift-back" Trust assets to Grantor
- EPTL Section 7-1.9: An Irrevocable Trust can be amended or revoked by the Grantor upon consent of all persons who have a beneficial interest in the trust
 - Requires written consent of all living primary and contingent beneficiaries
 - Minors or incapacitated primary and contingent beneficiaries lack capacity to consent

WHAT IF GRANTOR NEEDS TRUST PRINCIPAL

- Grantor Exercises Limited Power of Appointment retained in Irrevocable Trust

-Grantor designates a limited number of adult living beneficiaries as trust remainder beneficiaries
i.e. trust remainder to my children who survive me

- Grantor then amends or revokes a portion of trust, upon written consent of limited beneficiaries, to return a portion of trust principal to Grantor