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Medicaid Asset Protection Trust
(The Irrevocable Income Only Trust)
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Medicaid Asset Protection: Irrevocable Income Only Trust

- Irrevocable Income Trusts for advance planning for homestead, other real estate/condominium, and other assets to 'lock away' principal of the trust
 - Preserve trust estate from Medicaid claims if nursing home care needed
 - Preserve trust estate from estate claims by Medicaid by avoiding Surrogate proceeding (probate or administration)
- Transfer penalty begins from date of funding not date of Trust signing
- No difference in penalty period for life estate, outright transfers, or to the irrevocable Medicaid trust.

Medicaid Asset Protection: Irrevocable Income Only Trust

- Why advise client to prepare irrevocable trust instead of outright transfer?
 - Considering transfer of homestead and possibility of sale in future (capital gains tax)
 - Considering transfer of homestead and a disabled adult child or other family member resides in home (not care giver child) and want to preserve against possibility of 'their' Medicaid liens or estate claims
 - Potential beneficiary (e.g. adult child) divorce, possible bankruptcy or other credit issues; and life estate transfer is 'risky'

Trust Requirements (Gruer page 73)

- NY statutory requirements:
 - Must be in writing (no declaration of trust)
 - Signed and acknowledged by Grantor/Settlor/Creator in same manner as required for transfer of real estate (Use uniform acknowledgement RPL 309-a) & signed before notary
 - If signed before two witnesses, see RPL 309-a for proper acknowledgement
 - Trustees must also sign and acknowledge the trust before notary
- EIN for trust not required when homestead funds trust. Obtain EIN prior to sale or at Grantor's death (SS-4 online at IRS website)

Trust Requirements

- Matter of D'Elia, 2013 NY Slip Op 23157 (4/10/13, Surr. Ct Nassau Cty)
 - Will offered for probate was 'pour over' to inter vivos trust
 - Will stated: "I give and bequeath the residuary of my estate to the Trust executed "on or before the date of this will and prior to the execution of this will..."
 - Will executed 3/22/11
 - Trust signed/acknowledged by Settlor 3/22/11
 - One Trustee signs/acknowledged 3/29/11

Trust Requirements

Matter of D'Elia, continued

- Decedent/Grantor dies October 2011 leaving spouse and three adult children, with one adult child predeceased (leaving 2 minors)
 - Will also has 'incorporation by reference' clause as to terms of trust
- Issue: whether the bequest of the decedent's residuary estate fails because the trust was not in existence at the time of the execution of the will
- No Medicaid apparently involved in this case

Trust Requirements Matter of D'Elia (cont'd)

- EPTL 3-3.7 permits a testator to make a pour-over bequest to a trust through a will "provided that such trust instrument is executed and acknowledged by the parties...prior to or contemporaneously with the execution of the will, and such trust instrument is identified in such will."
- Court discusses limited exceptions to 'timing' of execution to prevent fraud; presumption against intestacy for the residuary. (citations omitted)

Trust Requirements Matter of D'Elia (cont'd)

- Decision examines the legislative history of inter vivos time trusts, codification of EPTL 7-1.17 and 3.37.
- "...trustee, however, did not sign the trust agreement until March 29, 2011. Thus, the trust was not in existence at the time the will was signed."

Trust Requirements

Matter of D'Elia (cont'd)

- Court holds:
 - “Although mindful that the benefits of estate planning on the decedent's part may be affected by finding the pour-over invalid, the unavoidable result is that the residuary bequest under the decedent's purported will fails as the trust was not in existence at the time the purported will was executed. The default provision in the second paragraph of Article III is likewise ineffective as a further failed attempt to incorporate by reference the provisions of the trust. The residuary estate shall pass pursuant to the rules of intestacy (EPTL 4-1.1). “

Trust Requirements

- Another caution: Inter vivos trust (whether irrevocable or revocable) which provides that payments from trust will stop when the Settlor or their spouse applies for Medicaid are not permitted under EPTL 7-3.1(c)
 - Void as against public policy
 - No trigger provisions since August 1992

Medicaid Eligibility Rules (Gruer page 74)

- General rule: non-exempt or uncompensated transfers made for the purpose of qualifying for Medicaid result in 60 month period of ineligibility for chronic care (nursing home) benefits paid for by Medicaid.
- Deficit Reduction Act of 2006 effective 2/8/2006

Medicaid Eligibility When does Penalty Period start?

- Client not in nursing home:
 - Penalty period for transfers, including to irrevocable trust, begins month following month of trust funding (deed transfer, completed conveyance of financial assets) for 60 months
 - Last transfer triggers start of penalty period
- Client in nursing home: 1st day of month after which assets are transferred, or the date on which the otherwise eligible individual is receiving nursing facility services for which MA coverage would be available but for the imposition of transfer penalty...and which does not occur during any other penalty period. (page 75)

Medicaid Eligibility: When does Penalty Period start?

- Relationship to Irrevocable Trust
 - My case: Senior in nursing home for long term care; owns real property and fair market value is determined and verified
 - Senior also owns cash (here, equivalent amount to property valuation)
 - Irrevocable income trust created by senior and real property conveyed to trust by deed
 - Cash transferred to niece and promissory note plan established using cash.
 - At end of note period, irrevocable trust protected (17 month note)

Income Tax (Gruer page 76)

- IF Irrevocable Trust drafted to require distribution of all income, it is simple trust for federal income tax purposes
- If income not required to be distributed or not fully distributed, draft trust as Grantor trust for income tax purposes to reduce or minimize income taxes
- For Medicaid purposes, most irrevocable trusts are drafted to distribute all income to Grantor

Income Tax

- Income to beneficiary 'flows' through trust and reported on beneficiary personal Form 1040
 - Trust issues K-1
 - Reporting on Form 1040 more beneficial
 - Why? Page 77 (Gruer) tax rates are better for individuals than for trusts
 - 2014, federal rate is 39.6% for \$12,150.00 for trusts
 - Versus: 39.6% tax rate for \$406,750.00 for single individual

Income Tax

- Other factors contribute to analysis of income taxation of trust
- Page 78 (Gruer)
 - IRC §1411 imposes additional 3.8% tax on certain net investment income above specific statutory amount
 - Net Investment Income Tax on certain non-grantor trusts for undistributed net investment income and with adjusted gross income over dollar amount at which highest tax bracket begins for a taxable year (2014 is it \$12, 150.00)

Structuring Grantor Trust

- Drafting considerations to make the irrevocable trust a grantor trust
 - Materials list the IRC sections for grantor trust
 - §§ 673 to 677
 - Caution: §675 'power to revoke' not appropriate for Medicaid trust
- Best practice: use clause 'substitution of trust property for property of equal value' (IRC §675 (4))
- See page 79 (Gruer) for other drafting options under Grantor Trust provisions

Structuring Grantor Trusts Capital Gains Exclusion

- Tax Basis
 - Best practice: IRC §121 single taxpayer may exclude \$250,000 from gain on sale of personal residence (\$500K for married couple, or sale within one year of death of first spouse) if lived in residence for 2 of prior 5 years
 - Preserve capital gains tax exclusion in Trust
 - Grantor trust can be treated as owner of principal for capital gains tax purposes (and IRC §121)
 - Retain certain administrative powers including IRC §675(4) [power to substitute property]
 - See page 81 of materials for other options under §675 (4)

Other Drafting Considerations (Gruer page 114 – 117)

- Waive invasion of trust by court under EPTL §7-1.6
 - The section authorizes the court in its discretion to "make an allowance from principal *to any income beneficiary* whose support... is not sufficiently provided for" unless waived in the trust instrument
 - Matter of Bross, 167 Misc 2nd 37 (NY Cty Surr Ct 1995) Interesting case (pre 1993 OBRA trust) discusses invasion of testamentary trust f/b/o surviving spouse on Medicaid under §7-1.16

Other Drafting Considerations

- Make sure language of trust gives the senior Grantor the right to occupy the property for their lifetime, in addition to income right
- Some refer to this as the 'life estate' language in the trust
- Best practice: Grantor consent to the sale of the homestead and Trustee may purchase a replacement or substitute residence.
- Make sure the family understands that if homestead in Trust is sold, and Senior opts for rental or assisted living, only the income from the trust (not principal) available to defray that expense

Other Drafting Considerations

- Add to general powers of trustee the authority to change the situs of the Trust to any jurisdiction, with right by Trustee to elect to have trust administered under laws of jurisdiction to which transferred
- Remind clients about homeowner and title insurance considerations (that home is in trust; whether home unoccupied)

Other Drafting Considerations

- Distribution of principal to children (or other remainder beneficiaries)
 - Sometimes drafted as Advance on Inheritance clause
 - Trustee not Grantor is given discretion
 - Best practices: exercise of power is in writing and recipient signs receipt (like a receipt and release); if other beneficiaries will not receive advance, consider having them sign waiver of liability against Trustee (would require discussion with other beneficiaries as to purpose of advance)

Other Drafting Considerations (Enea, page 126)

- Less than full fee simple can be conveyed to the irrevocable trust
 - Retention of Life Estate for Senior outside of the trust
 - At sale, portion of proceeds to senior, outright
 - Flexibility to invest those sale proceeds in another residence (or purchase interest in child's residence) but preserves bulk of sale proceeds in trust

Other Drafting Considerations

- Decanting under EPTL §10-6.6
- Hypothetical
 - Irrevocable Trust without Limited Power of Appointment (testamentary nor inter vivos)
 - Trust needs to be amended but there remainder persons under a disability (minors or incapacitated/incompetent) who cannot consent (EPTL §7-1.9)
 - Or, even if all remainder persons can consent, one beneficiary will now need Special Needs Trust and dispositive provisions need to be changed
- Read statute carefully to see if legally possible to decant if presented with executed trust

Other Drafting Considerations

- What happens after the Grantor dies and there is a surviving spouse?
 - Best practice: draft separate trusts for each spouse
 - Consider continuing trust for benefit of each surviving spouse (for Medicaid planning) after death of particular Grantor
 - Remember that if you draft 5/5 power authorizing surviving spouse to receive \$5,000 and up to 5%, Medicaid will require this distribution
 - Best practices: don't include 5/5 power
 - Income to surviving spouse protects that survivor

Gift Tax Consequences

- Transfer to trust is completed gift – gift tax return (Form 709) required
- However, Settlor may retain testamentary Special (Limited) Power of Appointment under IRC regulation §25.2511-2(c)
- Grantor cannot appoint the Trust principal to himself, his estate, his creditors or the creditors of his estate

Gift Tax Consequences

- But see: 2/24/12 IRS Chief Counsel Memorandum where Settlor did not retain inter vivos limited (special) power of appointment, retention of testamentary power did not render gift to trust incomplete since trustees had discretion to distribute trust property during trust term (Gruer page 82)

Gift Tax Consequences

- New York State budget bill (3/31/14) for FY 2014-2015 says:
 - Non Grantor, incomplete gift trusts are treated as grantor trusts for NYS income tax purposes unless the trust was liquidated before 6/1/14 (or where not liquidated, for income earned by the trust after 6/1/14)
- For estate tax purposes, certain gifts made (including to a trust) after 4/1/14 and during the 3 year period prior to death are required to be added back to the gross taxable estate

Medicaid, Grantor Trusts, and Special Powers of Appointment

- Income right preserves real property tax exemptions if trust beneficiary (Grantor) or spouse resides in the homestead
 - Veterans benefit
 - And see Gruer pages 85,86 distribution of trust income and VA benefit or Improved pension benefit
 - Senior Citizen Tax exemption(STAR)
 - Income based (owner and spouse income \$500,000 or less for basic STAR)
 - Enhanced STAR income for senior age 65 or older less than \$83,300 (2014)
 - May reduce income taxes if income is distributable (individual rates more favorable than trust rates)
- Prior litigation where Medicaid challenged Grantor's special power of appointment making trust an available resource were rejected by Federal and NYS courts.

Other Considerations

- Can an agent under Power of Attorney amend the irrevocable Trust? Will this affect Medicaid eligibility?
 - Perosi v. Li Greci (2nd Dept. 7/11/12)
 - Grantor establishes and funds irrevocable trust (ILIT) designating brother as trustee in 1991
 - Daughter is designated POA agent in 2010
 - Before Grantor's death, Daughter/POA exercises authority under POA to amend trust
 - Grantor dies 2 weeks later

Perosi v. LiGreci (cont'd)

- Post 9/2009 POA
 - Daughter/Agent appointed self and her son as co-trustees and removes Grantor's brother
 - Agent uses EPTL 7-1.9 (amend on consent of all remainder beneficiaries) to amend trust
 - After grantor dies, his brother files objections (deprived of commissions)
- Court finds POA (General Obligations Law) permits agent to:
 - Perform all estate planning; and
 - “all other matters”

Perosi v. Li Greci (cont'd)

- Trust does not have boiler plate language prohibiting amendment under EPTL 7-1.9
- No change to dispositive provisions of trust
 - Therefore, court did not have to examine the SMGR
- What if Grantor had been Medicaid recipient?
 - If POA fails, would entire Trust residuary now be exposed to Medicaid claims? Does trust fail or only amendment?
 - What if challenge had been during Grantor's lifetime and on Medicaid?

Medicaid, Grantor Trusts, and Special Powers of Appointment

- Why inter vivos power of appointment?
 - Already discussed : IRS Chief counsel memorandum in materials
 - What if trust must be dissolved/revoked and there are minor beneficiaries (or persons lacking capacity) where consent cannot be obtained
 - (EPTL §7-1.9):

“Upon the written consent, acknowledged or proved in the manner required by the laws of this state for the recording of a conveyance of real property, of all the persons **beneficially interested in a trust of property**... the creator of such trust may revoke or amend the whole or any part thereof by an instrument in writing acknowledged or proved in like manner, and thereupon the estate of the trustees ceases with respect to any part of such trust property, the disposition of which has been revoked...” [other than charitable trusts]

Medicaid, Grantor Trusts, and Special Powers of Appointment

- Best practice:
 - Give Grantor both testamentary and inter vivos power of appointment
 - Flexibility for Grantor (but caution if by POA, Perosi v. LiGreci, supra)
- What about other powers for Trustee?
 - Caution about giving the Trustee powers which could benefit the Grantor
 - E.g. unreported case, In re Newman (2002, Queens Supreme Court) disagreed with Medicaid and held that power of trustee to make loans did not make trust an available resource to Grantor (and available for Medicaid)

Estate Tax

- IRC §§2036 and 1014 decedent's gross estate includes value of property or interest in property transferred to trust if
 - Decedent reserved life use, possession, right to income or other enjoyment of property
 - Or right, alone, to designate persons who enjoy or possess the transferred property or income
- With Medicaid Trust, Grantor retained income right for life, includible in gross estate and assets receive step up to date of death value

Thank you

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