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PROTECTING THE HOME:

THE USE OF IRREVOCABLE TRUSTS FOR ASSET PROTECTION AND MEDICAID PLANNING

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ASSET PROTECTION PLANNING FOR THE HOME

Typical Client Scenario:

Your client, Mrs. Bunker, is 78 years old and in good health. She is a widow with two children. Her assets consist of her home valued at $600,000 with no mortgage; an IRA Rollover from her husband of $240,000; $80,000 in stocks that she inherited from her father 30 years ago; and $100,000 in various bank accounts. She has Medicare, a Medicare Supplemental Insurance Policy and Medicare Part D. She does not have Long Term Care insurance. Her best friend recently went into a nursing home and is going through her life savings and her family sold her home to pay for her care. Mrs. Bunker does not want this to happen to her, and she particularly wants to leave her home to her children and grandchildren as an inheritance. She tells you that another neighbor transferred her home to her children. She asks you what she should do to protect her home.

- What will happen to the home if Mrs. Bunker applies for Medicaid for home care services?
- What will happen to the home if Mrs. Bunker applies for Medicaid for nursing home care?
- What are the consequences of transferring the home to Mrs. Bunker's children outright?
- What are the consequences if the home is transferred to Mrs. Bunker's children subject to a reserved life estate?
- What are the consequences if the house is transferred to a revocable trust?
- What are the consequences if the house is transferred to an irrevocable trust?

I. INTRODUCTION

An experienced elder law attorney will generally advise the client that the best option for protecting the house against expensive long term care costs is to transfer the house to an Irrevocable Trust. Irrevocable Trusts are often used in planning to protect a home from Medicaid claims. These trusts are particularly useful to protect the client's home, often the client's largest asset, but they can also be used to protect other assets. Typically, the Irrevocable Trust will provide that the client, who is the Grantor of the trust, retains the right to receive income from trust assets and the exclusive lifetime right of use and possession of the home. The drafter of the trust must carefully consider numerous issues when drafting the trust, including estate, income, gift and property tax consequences of the trust.

II. GENERAL AND DEBTOR CREDITOR PROVISIONS RELATING TO TRANSFERS AND TRUSTS

A full discussion of debtor-creditor law is beyond the scope of this outline, which focuses on the use of Irrevocable Trusts in the Medicaid planning context. However, estate planners should have a general knowledge of the salient provisions of New York regarding the ability of a court to invade the principal of a trust to satisfy the creditors of the creator.

A. Revocable Trusts have no creditor protection as they are fully available to the Grantor.

B. Unless otherwise provided in the governing instrument, a court may in its discretion award principal from a trust for the benefit of an income beneficiary whose support or education is not sufficiently provided for, if the other adult and competent beneficiaries so consent, or upon a hearing on notice to all of the other beneficiaries, if the court is satisfied that the original purpose of the creator of the trust cannot be carried out and the invasion effectuates the intent of the creator. E.P.T.L. §7-1.6.

C. A transfer of assets to an Irrevocable Trust will generally be made without fair consideration. Debtor Creditor Law §273 provides that "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent, is fraudulent as to creditors without regard to his actual intent if the conveyance is made or the obligation is incurred without a fair consideration."

D. Debtor Creditor Law §270 defines a "creditor" as a person having any claim, whether matured or unmatured, liquidated or unliquidated, absolute, fixed or contingent.

E. Pursuant to Debtor Creditor Law §274, a conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands is an unreasonably small capital, is fraudulent as to creditors and as to other persons who become creditors during the continuance of such business or transaction without regard to actual intent.

F. Pursuant to Debtor Creditor Law §275, every conveyance made and every obligation incurred without fair consideration when the person making the conveyance or entering into the obligation intends or believes that he will incur debts beyond his ability to pay as they mature, is fraudulent as to both present and future creditors.

G. Pursuant to Debtor Creditor Law §276, every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay or defraud either present or future creditors is fraudulent as to both present and future creditors.

H. If a conveyance is found to be fraudulent, the creditor, bankruptcy receiver, or trustee may be entitled to recover reasonable fees for the proceeding to set aside the conveyance. Debtor Creditor Law §276-a.

I. Prior to the enactment of federal and New York State legislation imposing specific penalties for individuals who transfer assets prior to submission of Medicaid applications, there were a few decisions by New York courts holding that a transfer of assets by an elderly individual who later applied for Medicaid might violate fraudulent conveyance laws. See, Crabb v. Mager, 66 A.D.2d 20, 412 N.Y.S. 2d 508 (4th Dept. 1979) which upheld a denial of a motion to dismiss for failure to state a cause of action in a fraudulent conveyance proceeding commenced by a local department of social services commenced against the estate of an individual and her son and daughter-in-law to whom the individual transferred her home prior to entering a nursing home. See also, Bandas v. Emperor, 121 Misc.2d 192, 467 N.Y.S.2d 749 (Sup. Ct. Cayuga Co. 1983) in which the Court denied a motion to dismiss an action to set aside a transfer at a time when there were no New York statutes in effect prohibiting transfers of assets by individuals who applied for Medicaid. Subsequent to enactment of the federal transfer of asset provisions contained in the Omnibus Medicaid Reconciliation Act of 1993 and New York's implementing legislation discussed below, no New York court has set aside a transfer of assets to an irrevocable trust by an individual who subsequently applied for Medicaid as a fraudulent conveyance. In the opinion of the author, the enactment of federal and New York State legislation specifically addressing the effect of transfers of assets upon Medicaid eligibility has pre-empted the field and prohibits states from utilizing fraudulent conveyance statutes to invade assets placed into trusts. See, "In Defense of Medicaid Planning: Federal Law Prohibits States From Applying Debtor-Creditor Laws to Asset Transfers" by Frances M. Pantaleo and Robert M. Freedman, NAELA Quarterly, Volume 7, Number 4, Fall 1994.

III. MEDICAID ELIGIBILITY AND TRANSFER RULES

A. **Financial eligibility** for Medicaid services is based upon review of both the income and resources of the applying individual or family. The income and resource thresholds are revised annually.

B. **Income**:

i. In 2018, the **maximum monthly income** for an individual receiving Medicaid services in the home is $842. For a couple, the monthly income allowance is $1,233 if both will be receiving Medicaid services.

ii. Individuals in the community who have income in excess of the permitted allowance can "spend down" their surplus income on medical care or deposit surplus income into a "pooled income trust" managed by a not for profit agency.

iii. If receiving Medicaid payments for a nursing home, a single Medicaid recipient may only keep $50 per month of income and all income over this allowance must be paid to the nursing home.

iv. Married individuals who are receiving Medicaid in a nursing home can divert a portion of their income to a spouse living in the community, if the spouse has monthly income of less than $3,090.

v. The Medicaid program budgets gross income, with no deductions for income taxes. However, deductions are permitted for health insurance premiums.

C. **Resources:**

i. In 2018, a single individual is permitted to have $15,150 in countable assets. A couple may have combined countable assets of $22,200.

ii. **Exempt assets** include:

1. a pre-paid irrevocable burial contract of any amount
2. burial space items (such as a plot or tombstone)
3. a burial fund of $1,500 (unless the pre-paid contract includes payment of more than $1,500 for non-burial space items)
4. qualified retirement accounts such as IRA, 401k and 403b accounts, however these accounts must be placed into "periodic payment status" and the income so distributed will be budgeted as income.
5. a primary residence if it has an equity value of less than $858,000 (2018.)

iii. Although the home is generally an exempt asset, the Medicaid program has a **right of recovery** from the probate estate for the full value of Medicaid provided to the decedent on or after the decedent's 55th birthday. The Medicaid program will be a preferred creditor of the estate, with priority over the rights of ordinary creditors. No recovery may be made if the recipient has a **s**urviving spouse, or if the recipient has a child who is under the age of 21 or certified blind or disabled. Social Services Law §369.

iv. If the Medicaid recipient is in a nursing home, the Medicaid program has the right to place a **lien** against the home. However, no lien may be imposed if the home is occupied by a spouse, a child under the age of 21, a certified blind or disabled child or a sibling with an equity interest in the home who has lived in the home for at least one year prior to the institutionalization of the Medicaid recipient. Social Services Law §369.

v. Assets over the exemption must be spent down on medical care unless there are grounds for exempt transfers, discussed below.

D. Transfers of Assets:

i. **Sources of law**: 42 U.S.C. §1396(p); Social Services Law §366; 18 N.Y.C.R.R. 360-4.6; O6 OMM/ADM-5.

ii. Transfers of assets during the sixty month period prior to the submission of an application for Medicaid payments for institutional (i.e., nursing home) care (the "**look-back period**") will cause a period of Medicaid disqualification for payments for nursing home care ("**penalty period**") unless the transfer falls within certain exempt categories discussed below.

iii. The penalty period is calculated by aggregating all non-exempt transfers of assets during the look-back period and dividing the result by the "**regional rate"** which represents the average cost to the Medicaid program for a Medicaid bed in a nursing home in the region. The regional rates are updated annually. In 2018, the rates range from a low of $9,722 to a high of $13,053.

iv. The transfer penalty does not apply to individuals who apply for community (home care) Medicaid services. However, many of these individuals may be at risk of placement into a nursing home within 60 months. Individuals who ask to convert from community Medicaid to institutional Medicaid will be asked to provide documentation regarding transfer of assets during the look-back period.

v. **Exemptions from transfer penalties:** The primary residence may be transferred without penalty to a spouse, a child under 21, a blind or disabled child, a sibling with an equity interest in the home who has resided in the home with the Medicaid applicant for at least one year immediately prior to the institutionalization of the Medicaid applicant and to a "caretaker child" who has resided with the Medicaid applicant for at least two years immediately prior to institutionalization of the Medicaid applicant.

vi. Interspousal transfers of assets are frequently used to obtain immediate Medicaid eligibility if one spouse becomes ill and requires expensive long term care. However, the assets of the non-applying "well spouse" must be disclosed to the Medicaid program and the well spouse must submit a **spousal refusal statement** in order to prevent the transferred assets from being counted as available assets of the ill spouse. The spouse who executes the spousal refusal runs the risk that he or she may be sued for support by the local Medicaid agency. A discussion of spousal refusal strategies and protections is beyond the scope of this outline. However it is important to understand that although the spousal refusal strategy may protect the assets against the illness of one spouse, it will not protect the assets if the second spouse subsequently requires expensive long term care.

vii. **Transfers of assets to an Irrevocable Medicaid Trust** will generally result in a 60 month period of ineligibility for institutional Medicaid. The transfer penalty will apply to both spouses, even if the transfers are made by only one of spouse. Therefore, such trusts are most appropriate for clients who are young and healthy enough that they do not anticipate needing Medicaid coverage of institutional care for five years or who retain sufficient assets outside of the trust to pay for medical and ordinary living expenses for at least five years.

IV. IRREVOCABLE MEDICAID TRUSTS

A. Introduction:

Irrevocable Trusts are attractive to clients and their families since they provide income and the right to remain in the home, but protect the corpus of the trust for the clients' beneficiaries.

B. Medicaid treatment of Trust Income:

Any income which could be payable to the Grantor under the terms of the trust will counted as available to the Grantor for the purpose of determining Medicaid eligibility. The Department of Social Services is entitled to count as available to the Grantor any income or principal which the trustee has discretion to pay to or for the benefit of the Grantor, regardless of whether the trustee actually exercises that discretion. 18 NYCRR §360-4.5 (b) (1) (ii).

i. **Drafting Tip:** The trust should include language that the trustees do not have the power to adjust under E.P.T.L. §11-2.3(b) (5) A.

ii. **Drafting Tip**: The Grantor can specify how "income" is defined. Ordinarily, the Grantor will want the trustees to have unilateral discretion regarding the investment of trust assets and the authority to direct investments towards growth rather than income. Therefore, most trusts should specify that the trustee shall not have the power to elect unitrust provisions under EPTL §11-2.4. However, if the Grantor is concerned about losing control of the corpus of the assets transferred to the trust or wants to maximize income distributions, the trust could define income as an annuity payment greater than actual trust income or could require the trustee to elect the unitrust status.

iii. Most practitioners draft the trust to require that all income be paid to the Grantor in order to assure that the value of the trust will be includable in the Grantor's taxable estate. (See tax discussion below.) If the trust requires the distribution of income to the Grantor and this income is not actually distributed to the Grantor during the "look-back period", the Medicaid program may budget the undistributed income as available to the Grantor or assess a transfer penalty for the Grantor's failure to demand payment of such income.

C. Medicaid Treatment of Trust Principal:

i. The Irrevocable Medicaid Trust must state that the trustees may not distribute or apply the principal of the trust to the Grantor under any circumstances, thus making the principal unavailable for the purpose of Medicaid eligibility. If the trustee is given any discretion to pay principal to or for the benefit of the Grantor, then the trust principal will be counted as an available resource of the Grantor. 18 N.Y.C.R.R. §360-4.5 (b) (1) (ii).

ii. Since E.P.T.L. §7-6.1 allows the invasion of trust corpus for the benefit of an income beneficiary, the Irrevocable Medicaid Trust should contain a provision explicitly stating that E.P.T.L. §7-6.1 shall not apply.

iii. **Trigger Trusts**: If the trust limits, suspends or diverts income or principal upon a trigger such as an aplication for Medicaid, placement of the Grantor into a nursing home, or disability of a Grantor, the provision is void as against public policy and the trigger will be ignored in determining whether the trust income or principal will be considered available to the Medicaid applicant. E.P.T.L. §7-3.1(c); 18 N.Y.C.R.R. §360.4.5(a), 96 ADM 8.

iv. It is generally advisable that the trust contain provisions permitting the trustees to make distributions of principal to a class of beneficiaries during the lifetime of the Grantor. This power will give the trustees the ability to get funds out of the trust for the benefit of the Grantors, if they choose to do so, as well as provide a mechanism to get funds out of the trust for the beneficiaries if the Grantor truly doesn't need the funds. However, the Grantor must be made aware that he or she will have no right to compel the trustees or any beneficiary to take distributions from the trust to be used for the Grantor. Moreover, the drafter should be aware of E.P.T.L. §10-10.1 which provides that the authority of a trustee to make discretionary distributions to herself is limited to distributions for health, education, welfare and support unless the language of the trust specifically grants the trustee unlimited discretion. Moreover, as most drafters will want to avoid giving the trustee a general power of appointment over the trust, the better practice is to name at least two trustees so that fully discretionary distributions to a trustee can be made by the co-trustee.

v. The trust should not include language which would permit the trustees to pay burial expenses of the Grantor upon the Grantor's death as some local departments of social services have deemed this as giving the Grantor a power to receive principal of the trust, thereby making at least a portion of the trust corpus available to the Grantor.

V. REVOCABLE TRUSTS AND MEDICAID

A. Revocable trusts will be counted as fully available to the Medicaid recipient. Therefore, they do not protect cash or securities from exposure to long term care costs.

B. There are numerous Medicaid fair hearing decisions which have held that a transfer of a home to a revocable trust will not cause an otherwise exempt residence to be a countable asset, although there are reports that some local social services districts will deny Medicaid eligibility if a residence is held in a revocable trust.

C. A home held by a revocable trust will not be subject to Medicaid estate recovery as the asset will pass outside of probate. However, the residence will be subject to a Medicaid lien if the Grantor receives Medicaid payments for nursing home care. Moreover, if sold during the lifetime of the Grantor, the proceeds from the sale will become fully available and cause disqualification of the Grantor.

VI. TAX CONSIDERATIONS

A. Gift Tax Considerations:

i. A transfer to an irrevocable trust is ordinarily a completed gift that is subject to federal estate and gift tax reporting rules. With the Uniform Credit now in excess of $11 million and the New York State estate tax exemption in excess of $5 million, few individuals who are concerned about paying for the cost of long term care will need to be concerned about paying a gift tax for assets transferred to an Irrevocable Medicaid Trust. However, if the gift is complete, a gift tax return must be filed.

ii. If the Grantor wants to avoid the requirement to file a gift tax return, or there are other reasons to make the gift incomplete, the Grantor should retain a Special Power of Appointment. See sample Power of Appointment provisions appended at the end of this article and discussion below.

B. Estate Tax Considerations:

If the Grantor has retained the right to receive all income from the Trust, the entire value of the trust at the date of death will be included in the Grantor's taxable estate. I.R.C. §2036.

C. Tax Basis Considerations/Step-Up in Basis:

i. The Grantor will generally want to structure the assets in the trust to qualify for a step-up in basis upon the Grantor's death. I.R.C. §1014(a) provides that the basis of property ***acquired from a decedent*** is the fair market value at the time of the decedent's death. Subsection (b) provides that property acquired from a decedent includes property required to be included in determining the value of the decedent's gross estate for estate tax purposes.

ii. I.R.C. § 2036 defines a gross estate as including the value of all property of which the decedent has at any time made a transfer by trust or otherwise under which the decedent had retained for his life:

   1. the right to possession, enjoyment or income from the property (such as a continuing income interest in trust or a life estate, or

   2. the right, either alone or in conjunction with another person, to designate the persons who shall possess, enjoy or obtain income from the property (i.e. power of appointment).

D. Income Tax Considerations/Grantor Trust Rules:

i. The Grantor will generally want one or more of the **Grantor Trust Rules** found at I.R.C. §§ 671-677 to apply to the trust so the trust is:

   1. taxed as if the property is owned by the Grantor and not by the trust itself as trusts are generally taxed at significantly higher (i.e. more compressed) income tax brackets than an individual, and is

   2. entitled to favorable capital gains tax treatment upon the sale of the residence so that the trust is taxed as if the property were owned directly by the Grantor. I.R.C. §121.

ii. When qualifying the trust as a Grantor Trust, the drafting attorney must take into consideration the impact on the Grantor's Medicaid eligibility.

iii. The **Grantor Trust Rules** apply and the Grantor is deemed owner of trust for tax purposes if one of the following I.R.C. provisions apply:

   1. **§673:** The Grantor is the owner of reversionary interest in income or corpus. However, giving the Grantor a reversionary right to principal would render the Grantor ineligible for Medicaid.

   2. **§674:** The Grantor is the owner of a power to change the beneficiaries of the trust (i.e. **special power of appointment**). This power can also be owned by a non-adverse party or both. This causes a step-up in basis pursuant to I.R.C. §§ 1014 and 2036 which provide a

step-up in basis for property in trust over which a decedent, either alone or in conjunction with another person, possesses a power of appointment. The power of appointment maybe exercised by a lifetime instrument or by Will. A lifetime power of appointment over principal will cause the capital gains to be taxed to the Grantor. I.R.C. 674(a). A testamentary power of appointment over the principal will cause capital gains to be taxed to the Grantor if they are accumulated and added to the principal. I.R.C. §674(b).

a. Clients like the power of appointment as it allows them to retain control over the ultimate disposition of trust assets. Children can still be disinherited, the class of beneficiaries can be enlarged and assets can be left in trust rather than outright to beneficiaries who subsequently develop creditor or marital troubles, or have special needs.

b. The special power of appointment can be useful if the Grantor needs to revoke the trust because of an unexpected illness, need for trust assets and/or inability to get through the five year look-back period. See discussion of revocability of irrevocable trusts below.

3. **§675:** The Grantor has excessive administrative control that is exercisable for the benefit of the Grantor rather than the beneficiaries. Specifically, consider utilizing §675(4) (C) which treats the Grantor as owner if the Grantor has power to reacquire the trust corpus by substituting other property of an equivalent value, without the approval or consent of another person in a fiduciary capacity. This power should be sufficient to cause capital gains to be taxed to the Grantor. However, it does not alone cause estate tax inclusion required for the step-up in basis. For this, the trust must either require that all income be paid to the Grantor or give the Grantor other powers over income.

a. **WARNING**: Will the power to substitute property of equivalent value cause a problem with the Grantor's eligibility for Medicaid? The author is not aware of any fair hearing decisions or cases in NY State which have held trust assets to be available due to the Grantor's retention of this power. However, fair hearing decisions in Florida and other states have held that the substitution power makes the trust an available resource.

4. **§676:** The Grantor has the power to revoke the trust. This will cause the trust property to be available to the Grantor and countable for the purpose of the Grantor's Medicaid eligibility. See discussion of Revocable Trusts above.

5. **§677**: The Grantor has power to distribute income to himself or spouse. This will only give Grantor Trust status over income and not

principal (i.e. corpus) which is insufficient for §121 treatment regarding the sale of the residence since it is not a power over corpus.

E. Capital Gains Considerations upon Sale of Residence:

i. A major tax consideration is I.R.C. §121 which provides a $250,000.00 exclusion of gain ($500,000.00 for married couples filing a joint return) for a taxpayer who owns and occupies a principal residence for two of the last five years immediately preceding the date of sale. The exclusion is increased to $500,000 in the case of a sale or exchange of property by an unmarried individual whose spouse is deceased on the date of such sale, if such sale occurs within two years after the date of death of such spouse and the requirements of the exclusion were met immediately before such date of death. The exclusion applies regardless of age. The exclusion can be used once every two years, but indefinitely.

ii. **PRACTICE TIP**: If the Grantor retains the right to trust income and both a lifetime and testamentary special power of appointment over principal of the trust, he will achieve §121 capital gains tax benefits while preserving the protection of the trust assets from being considered available assets by the Medicaid program. The power of appointment should be testamentary as well as lifetime to avoid a potential IRS claim that the trust is akin to a life estate and thus (like a life estate) the proceeds from the sale of the residence should only receive favorable capital gains treatment as to the portion allocable to the life interest.

iii. In **Verdow v. Sutkowsky**, 209 F.R.D. 309 (N.D.N.Y., 2002), the Northern District Federal Court ruled that the retention of a power of appointment by the Grantor of an irrevocable trust did not render the trust an available resource for Medicaid eligibility. This decision has been followed in New York although other states report that the inclusion of the power of appointment will cause the trust corpus to be deemed an available resource.

iv. Some commentators have expressed concerns that lifetime powers of appointment may create potential title problems. However, in the experience of the author, if the lifetime power is drafted to require receipt by the trustee of the document exercising the power, title companies do not have a problem with the existence of the lifetime power of appointment in the document or accept a written statement by the trustees that they have not received exercise of the power of appointment.

F. Property Tax Considerations:

i. If the Grantor has retained the obligation to pay taxes related to the residence and the exclusive right to use and occupancy of the residence held by the trust, the Grantor will retain eligibility for any Senior Citizen, Enhanced Star and Veteran's exemptions which apply to the property.

VII. ADVANTAGES OF THE IRREVOCABLE TRUST OVER OUTRIGHT GIFT

A. The Grantor may keep income for support and independence.

B. The transfer to the trust is not a completed gift if the Grantor retains a special power of appointment.

C. The beneficiaries receive trust assets with a step-up in basis upon death of the Grantor.

D. Capital gains taxes can be avoided if the home is sold during the lifetime of Grantor.

E. The trust income will be taxed to the Grantor if the trust qualifies as a Grantor trust. This can extend to capital gains if the trust qualifies as a Grantor trust over income and principal.

F. The trust funds are legally segregated. This protects them from a number of potential problems compared to the outright gift, including:

i. Claims by creditors of the donees.

ii. Divorce of a donee. (Regardless of whether the spouse has a claim against the gifted property, it can and will often be an issue in the divorce.)

iii. Death of the donee. The property will stay in the trust to be distributed to the Grantor's designated beneficiaries rather than to the beneficiaries of the donee's estate.

iv. Malfeasance of the donee.

VIII. ADVANTAGES OF THE IRREVOCABLE TRUST OVER THE TRANSFER OF THE HOME BY DEED WITH A RETAINED LIFE ESTATE:

A. If using an Irrevocable Medicaid Trust to protect a home, the client should also weigh the advantages and disadvantages of transferring the home into the trust as contrasted with transferring the home by a deed with a retained life estate. Both options have the advantages of providing the Grantor use and some degree of control over the home during lifetime and step-up in basis upon the death of the Grantor.

B. The transfer of the home into the Irrevocable Medicaid Trust is not a present gift subject to gift taxes if the Grantor retains a special power of appointment. If the home is transferred with a reserved life estate, the gift of the remainder interest is a present gift. A special power of appointment contained in a trust will generally not create a title problems whereas the reservation of a power of appointment in a deed generally does.

C. The Medicaid Trust can give the Grantor the sole authority to determine whether the residence can be sold during the Grantor's lifetime. If the property is sold during the lifetime of the Grantor:

i. The trust can be drafted to require that the entire proceeds of the sale remain in the trust for the lifetime of the Grantor. If property subject to a life estate is sold, a portion of the proceeds will be distributed to the holders of the remainder interest and a portion of the proceeds must be distributed to the life tenant, thereby exposing the life tenant's portion to exposure to pay for long term care needs.

1. The Medicaid program values the life estate by determining the 7520 rate in effect at the time of the sale of the residence and determining the value of the life and remainder interests under the IRS Table S, Single Life Tables.
2. In September 2018 when this outline was drafted, the value of a life estate of an individual who is 85 years old is .17890 of the property. For a residence sold for a net sales price of $600,000, this would amount to $107,340 being paid to the life tenant, which would cause the life tenant to lose Medicaid eligibility.

ii. If the residence held by a trust is sold, the trust is generally drafted to permit the purchase of a new residence which remains in trust ownership and will continue to be an exempt resource for Medicaid qualification purposes.

iii. The trust can be drafted to qualify for favorable income tax treatment of the capital gains including qualifying the entire purchase price for §121 treatment. With a retained life estate, the retained life estate would qualify for §121 treatment, but the remainder interest would not, unless the holder of the remainder interest had owned and lived in the home for two of the last five years.

IX. DISADVANTAGES OF IRREVOCABLE MEDICAID TRUST COMPARED TO A TRANSFER OF THE HOME WITH A RETAINED LIFE ESTATE:

A. The trust is more complicated.

B. The trust is more expensive to create and administer.

C. The penalty period of ineligibility for Institutional (Nursing Home) Medicaid may be longer since it is based upon the total value of the home rather than the value of the home minus the value of the retained life estate. However, since the implementation of the Deficit Reduction Act which changed the calculation of penalty periods for transfers of assets, in most cases, the creator will not be able to apply for institutional Medicaid for 60 months anyway.

X. OOPS! WE MADE A MISTAKE. WHAT IF CIRCUMSTANCES CHANGE? CAN AN IRREVOCABLE TRUST BE CHANGED OR REVOKED?

A. The loss of control over assets is one of the biggest barriers to clients who consider transfer of assets to an irrevocable trust. This is partly a psychological barrier but clients are rightly concerned that without a crystal ball, it may be impossible to know for certain that they may not want to sell their home in the future, suffer an unexpected health crisis such as a stroke or want the return of trust corpus.

B. If the Grantor desires only the ability to change the beneficiaries who will inherit the trust upon the Grantor's death, this can be accomplished by giving the Grantor the special power of appointment.

C. If the Grantor needs to revoke the trust due to need to access trust principal to pay for care as a result of unanticipated nursing home placement before the look-back period expires, the Grantor and the trust beneficiaries can utilize the provisions of E.P.T.L.§7-1.9(a) which permits the Grantor of an irrevocable trust to revoke the trust "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 (the) trust."

D. If the conveyance or other instrument creating the trust was recorded, the instrument revoking or amending the trust together with the consents thereto, shall also be recorded. E.P.T.L. §7-1.9(b).

E. If the trust provides for distribution to the issue per stirpes of the Grantor, and this class of beneficiaries includes minors, the trust may not be revoked even if the minor's parent is alive and the minor will not inherit unless the parent dies before the Grantor. Whittemore v. Equitable Trust Co. of New York, 250 N.Y.298 (1929) A guardian of the property of the infant cannot consent to revocation on behalf of the infant. Application of Michael, 70 Misc.2d 301; aff'd, 39 A.D.2d 865.

F. Inclusion of a lifetime power of appointment provides the Grantor with a simple way to assure that the trust can be revoked in the future if there is a drastic change in circumstance. The Grantor can execute an acknowledged document which exercises the power of appointment by eliminating any and all beneficiaries who would not agree to revoke the trust, or are not legally able to do so. Once the exercise of the power of appointment has been accomplished, the Grantor and the remaining trust beneficiaries can revoke the trust and return all trust assets to the Grantor.

G. In order to assure that the trust can be revoked if the Grantor becomes incapacitated, the Grantor should sign a power of attorney which includes specific authority for the agent to modify, amend or revoke any trusts created by the Grantor. See, Matter of Perosi v. LiGreci, 98 A.D.3d 230 (2nd Dept. 2012) which upheld a modification of a trust by an agent under power of attorney.

H. If the Grantor has only retained a testamentary power of appointment, and the Grantor has capacity, the Grantor could write a Will which eliminates minor or problematic beneficiaries and then revoke the trust with the consent of the remaining beneficiaries. However, this will not be possible if the Grantor lacks capacity. Moreover, will this cause title problems if the residence needs to be sold? How can a title company be certain that the Grantor's Will exercising the power of appointment is valid?

XI. JOINT TRUSTS FOR A MARRIED COUPLE OR SEPARATE TRUSTS?

A. When the estate and gift tax exemptions were much lower, most attorneys would split the assets of married couples and create separate irrevocable trusts for each spouse.

One-half of the marital residence would generally be deeded to each trust, although if one spouse was expected to die sooner than the other, the entire residence might be transferred to a trust in the name of that spouse in order to take advantage of the step-up in basis upon death if the residence was likely to be sold upon the first spouse's death.

B. With the increases in both the New York and federal estate tax exemptions, many practitioners are moving towards greater use of joint irrevocable trusts. However, the drafting of these trusts is considerably more complicated. Considerations will include whether the trust will become irrevocable upon the death of one spouse. Additionally, should both spouses be given a special power of appointment? Which will control if both are exercised?

SAMPLE TRUST PROVISIONS

ARTICLE II - DISPOSITIVE PROVISIONS DURING THE LIFE OF GRANTOR

The trustees shall hold, manage, invest and reinvest the assets of the trust, collect and receive the income therefrom and the trustees shall distribute, apply and/or accumulate the net income and principal of the trust in the following manner:

Income

(A) The trustees, after paying all proper charges, expenses, and commissions related to the administration of the trust, and the maintenance and repair of the property contained therein, shall pay over, in at least quarter-annual installments, the entire net income of the trust to or for the benefit of the Grantor for so long as the Grantor shall survive, thereafter, all income not so distributed shall be accumulated by the trustees, which income shall become a part of the principal of the trust and be distributed in accordance with the terms and conditions set forth in Article III herein.

Principal

(B) During the lifetime of the Grantor, the trustees shall have the discretion to pay to or apply for the benefit of **SON OF GRANTOR, DAUGHTER OF GRANTOR,** their spouses and their issue (such individuals hereinafter being referred to individually as "Lifetime Beneficiary" or collectively as "Lifetime Beneficiaries"), so much of the principal of the trust, as the trustees, in their sole and absolute discretion, deem necessary or appropriate. [1]

[1] Depending upon what is known about family dynamics, the net worth of the trustees or the wishes of the Grantor, the discretion of the trustees to make distributions of principal during the lifetime of the Grantor may be limited by an ascertainable standard, or require equal distributions among the class of permitted distributees. However, in most instances, trusts drafted by author provide the trustees with unlimited discretion over distributions from the trust during the lifetime of the Grantor, subject however, to the limitations discussed below.

Waiver of Provisions of Principal and Income Act

(C) The Grantor expressly waives the application of the terms and conditions of Section 11-2.3 (b) (5) of the Estates Powers and Trusts Law of the State of New York to the extent the provisions of such statute are applicable to this trust. The trustees shall not make an adjustment between principal and income pursuant to the provisions of the aforesaid law. Furthermore, no Court or Administrative agency may compel the trustees to make an adjustment between income and principal.

(D) The Grantor expressly waives the application of the terms and conditions of Section 11-2.4 of the Estates Powers and Trusts Law of the State of New York. The trustees shall not elect unitrust status for this trust pursuant to the aforesaid law to the extent the provisions of said statute are applicable to this trust. Furthermore, no Court or Administrative agency may compel the trustees to elect unitrust status for this trust. The trustees shall have the sole discretion regarding the investment of trust assets even if said investment decisions reduce the annual income payable to the Grantor.

Limitations on Trustee-Beneficiary

(E) Notwithstanding anything herein to the contrary, any distribution of principal of the trust to or for the benefit of a trustee who is also a beneficiary hereunder may only be made in the sole and absolute discretion of another trustee then acting hereunder. Furthermore, each other right, power, duty or discretion of any individual trustee who is also a beneficiary hereunder shall be deemed limited as necessary so that no right, power, duty or discretion conferred upon such trustee under this Agreement can be construed to be a general power of appointment under Section 2041 of the Internal Revenue Code of 1986, as amended, which would cause any assets of the trust to be included in the estate of said Trustee-Beneficiary at death. Any such right, power, duty or discretion which cannot be so limited shall be deemed null and void with respect to said Trustee-Beneficiary.

Manner of Distributions

(F) The aforementioned distributions of principal from the trust may be made by the trustees without reference to the financial resources which are or might be made available to the Lifetime Beneficiaries from other sources and without regard to the duty of any person to support the Lifetime Beneficiaries. Said distributions need not be distributed equally among the Lifetime Beneficiaries. The trustees shall have no discretion or authority to make any such distributions of principal to the Grantor during the Grantor's lifetime.[2]

ARTICLE III - DISPOSITIVE PROVISIONS FOLLOWING DEATH OF GRANTOR

(A) Upon the death of the Grantor, the trustees shall pay first from the income of the trust, and if the income of the trust is insufficient, then from the principal of the trust:

(1) all estate, inheritance and/or other death taxes of any kind which shall be assessed as a result of the Grantor's death with respect to all items included in the computation of such taxes, which pass under this Trust Agreement;

(2) all other administration expenses of the trust. [3]

(B) After the trustees have paid all of the taxes, expenses, and other costs referenced in the preceding subsection (A) hereof, all income of the trust not yet disbursed or otherwise distributed as heretofore directed shall be accumulated, added to and become a part of the

[2] (NOTE: Some practitioners require that distributions to or among the lifetime beneficiaries be made in equal amounts to all of the lifetime beneficiaries unless all or a majority consent to the unequal distribution.)

[3] The Trust should NOT permit the Trustees to pay burial expenses of the Grantor, as some Departments of Social Services have held this to be a reservation of a right to principal by the Grantor, thereby causing a portion of the trust to be treated as an available assets to the Grantor.

principal of the trust (hereinafter collectively referred to as the "Trust Property"). The trustees shall continue to hold, pay over and distribute the Trust Property to such persons and in such proportions, in further trust or otherwise, in fee or lesser estates as the Grantor by either a lifetime instrument or the Grantor's Last Will and Testament duly admitted to probate may validly appoint, which lifetime and testamentary powers of appointment are specifically limited as set forth in Article V hereof.

<u>Dispositive Provisions Regarding Remaining Trust Property</u>

If the Grantor shall fail to exercise the lifetime or testamentary powers of appointment set forth in Article III paragraph (B) and Article V, and at least sixty (60) days have elapsed since the death of the Grantor, the trustees shall distribute the rest, remainder and residue of any trust property to the then surviving issue, *per stirpes*, of the Grantor.

ARTICLE V-
RESERVATION OF POWER OF APPOINTMENT BY GRANTOR

(A) **<u>Lifetime Limited Power of Appointment</u>**: The Grantor reserves the power, exercisable by written instrument, executed by the Grantor, duly acknowledged and delivered to the Trustees during the Grantor's lifetime expressly referencing this power, to appoint any part or all of the principal or income of the Trust, outright or upon Trusts, conditions or limitations, to or among a class of beneficiaries limited to Grantor's children, grandchildren and relatives by blood or marriage and any charitable organization other than governmental entities or any federal, state or local subdivision, department or agency thereof. No exercise of this power shall exhaust it. No such appointment shall be made to the Grantor, the Grantor's creditors, the Grantor's estate or the creditors of the Grantor's estate. The power reserved to the Grantor under this paragraph may be exercised by a duly appointed agent under power of attorney of the Grantor provided that the authority to exercise the power is contained in the power of attorney or by a conservator, committee or guardian of the Grantor, provided that the authority to exercise such power is granted by a court of law.

(B) **Testamentary Limited Power of Appointment:** The Grantor reserves the power, exercisable by the Grantor's Will or any codicil thereto, to appoint any part or all of the principal or income of the Trust, outright or upon Trusts, conditions or limitations, to or among a class of beneficiaries limited to Grantor’s children, grandchildren, relatives by blood, marriage or adoption and charitable organizations other than governmental entities or any federal state or local subdivision or agency thereof. No such appointment shall be made to the Grantor, the Grantor’s creditors, the Grantor’s estate or the creditors of the Grantor’s estate. This limited power of appointment may only be exercised by a Will of the Grantor which must be submitted for probate within ninety (90) days of the Grantor’s death, in the county of the Grantor’s residence, specifically referring to this section of this Trust.

ARTICLE VII-NON-ASSIGNABILITY

The interest of any beneficiary hereunder, either as to income or principal, shall not be anticipated, alienated or in any other manner assigned or pledged or promised by such beneficiary and shall not be reached by, or be subject to any legal, equitable, or other process, including any bankruptcy proceeding, or be subject to the interference or control of creditors or others in any way or manner. Notwithstanding any contrary provisions in this Trust Agreement, the Grantor shall retain the power in a non-fiduciary capacity, to exchange trust assets or purchase trust assets for full and adequate consideration.