

PRACTICLE EXAMPLES OF HOW ESTATE AND ASSET PROTECTON PLANNING CAN WORK FOR YOUR FAMILY

Fundamental Importance of Basic Estate Planning and How Failure to Plan Results in a Gift to the Internal Revenue Service

Facts:

Husband and wife are worth in total approximately \$1,500,000 and Husband is in the hospital and has been given little time left to live. It is a Wednesday afternoon, just prior to the Thanksgiving holiday weekend, when the health spouse enters the attorney's office and wishes to discuss estate planning options. The only existing estate planning documents in place for this particular couple were two old simple Wills.

Issue/Problem:

What are the estate tax ramifications of the husband dying prior to the expiration of the long holiday weekend and, assuming that he was unable to get any estate planning documents executed prior to such death.

Analysis/Solution:

Perhaps the largest mistake this client made was not having even a durable power of attorney in place as this fact alone would prevent the attorney from creating a trust for the husband immediately. A durable power of attorney is a legal document that typically allows husband and wife to grant each other the power to sign their respective names in order to pay bills or access financial accounts but, most importantly, it would also enable the wife, in this case, to create a trust for the husband.

However, since there was no such instrument in place prior to the husband losing the capacity to grant such a durable power of attorney, the attorney was forced to petition the court to have the wife appointed guardian for the husband and then petition the court to do an estate plan for the ward. Upon completion of this legal procedure, and provided the husband has not yet passed away, a revocable family trust can be established for the husband.

Finally, the problem with this approach is that it often takes time and can be costly whereas, if a simple durable power of attorney had been done as part of their advanced estate plan, the wife could have immediately established a trust on behalf of her husband, thereby insuring that he would not die prior to having his estate planning documents in place.

In the event the husband would have passed away prior to the establishment of his revocable trust, then he would have affectively wasted his current \$2,000,000 federal and \$1,000,000 Massachusetts exemption equivalent amounts. These amounts reflect the amount of assets an individual may pass, both federally and Massachusetts estate tax free. The trap for the unwary is that, if you do not use these exemptions either prior to your death or immediately

following your death, then you affectively lose them. In this case, the deceased husband's existing simple Will left the total \$1,500,000 worth of assets directly to the surviving spouse.

Assume further that the surviving spouse continued to live beyond 2011 and that her \$1,500,000 worth of assets did not grow at all. Assuming further that she dies in 2011 with an estate worth \$1,500,000 and that the federal and Massachusetts exemption amounts, as currently scheduled to be, are worth \$1,000,000 each. In that event, since her federal estate valuation would be \$1,500,000 and that exceeds the \$1,000,000 exemption amount, it would result in a taxable estate of approximately \$500,000, which would correspondingly result in a federal estate tax liability of approximately \$250,000. In addition, since the estate exceeds the \$1,000,000 exemption amount, Massachusetts would tax the entire \$1,500,000 and the resulting liability would be approximately \$64,200. This results in a total tax liability of \$314,200 between the federal government and Massachusetts.

However, in the event the wife was successful in establishing a revocable family trust for the husband prior to his demise and transferred approximately \$750,000 worth of estate assets to it, that trust would have served to shelter \$750,000 of assets from both the federal and Massachusetts estate tax systems. The trust would have insured that the surviving spouse would have been the trustee as well as a beneficiary of such assets during her life while insuring that any trust assets would not be includible in the surviving spouse's estate upon her demise.

Therefore, upon the death of the wife in our example, there would only be the balance of the estate, which again assuming no growth would be approximately \$750,000 in her trust, which would be subject to both federal and Massachusetts estate taxes. However, assuming she has passed away in 2011 or beyond, she would have her own \$1,000,000 federal and Massachusetts exemption amounts in tact and available to use to off-set her \$750,000 estate. Since the value of her gross estate would be less than these exemption amounts, there would be no federal or Massachusetts estate tax liability due.

In conclusion, either having basic estate planning trusts in place or the ability to get such trusts in place prior to your demise, generally serves to reduce and, in many cases, eliminate your estate tax liability thereby reducing any unnecessary gifts to the IRS. Furthermore, the trust planning would also serve to reduce or maybe eliminate the costs associated with the probate process.

How Do I protect my House from the Costs Associated with Long Term Care and How Long Does it Take?

Facts:

Husband and wife are age 79 and have a combined estate worth approximately \$800,000, consisting of the following assets. They own their home worth approximately \$400,000, miscellaneous investment accounts worth in total approximately \$200,000 and IRA accounts worth in total approximately \$200,000.

Issue/Problem:

The client wishes to protect their home from the costs associated with long term care while nevertheless retaining control over the home as well as not exposing it to any creditors of their children. Ultimately, they would like to pass this asset to their children in the most tax-efficient manner possible.

Analysis/Solution:

The recommendation would be for them to establish an irrevocable income only trust and to transfer the real estate to themselves as trustee of a nominee realty trust with their irrevocable trust serving as 100% beneficial owner. The deed to their residence would reflect the reservation of a legal life estate. This means that they will retain the right to live there for the balance of their lives.

The irrevocable trust will provide that both of them, as co-trustees, shall retain the ability to make discretionary distributions of income to themselves for the remainder of their lives. Furthermore, they will retain the ability to sell and manage the trust assets and, since the trust is a grantor trust, which means they are considered the owner for income tax purposes, they will retain the ability to avail themselves of certain capital gains tax exclusions associated with the sale of their primary residence.

In other words, in the event they decided to sell their home during their lives, there would be no capital gains tax to be paid provided, however, they have owned and used such property as their primary residence for two of the last five years, were married on the date of sale and the resulting gain did not exceed \$500,000. In essence, this trust enables the husband and wife the ability to continue to live in their home, rent it if they so desire, sell it any time they wish during their lives and avail themselves to the capital gains tax exclusions associated with selling your primary residence as well as use the proceeds from such sale to potentially down-size, especially in the event of the death of one spouse. Furthermore, any of these transactions may be accomplished with out the need to acquire any permission from the couple's children.

In essence, this trust technique enables the husband and wife to continue to do all of the things they could do prior to creating the trust while, nevertheless, placing a shield around the home in order to protect it from the costs associated with long term care. The first day of the month in which the property is transferred to the trust use to begin the Medicaid ineligibility period that is created as a result of transferring the home to the trust. The Medicaid ineligibility period is defined as the amount of time that an individual must refrain from applying for Mass Health Benefits following the transfer of assets to the trust. The Medicaid ineligibility period is determined by dividing the real estate tax bill assessed value of the home (only the remainder interest in the primary residence) by the state's average cost of nursing home care determined in accordance with current regulations in Massachusetts (\$232 per day or \$6,960 per month). Please note these numbers will vary depending upon your state.

In this case, husband and wife reside in Massachusetts and the assessed value of their home is approximately \$400,000 while the remainder value of their home, based on their age, is

worth approximately \$200,000, and would generate a disqualification period of approximately 28.7 months. To the surprise of many people, note that this disqualification period is shorter than both the 36 month and 60 month look back periods that many people confuse with the penalty or disqualification period. Finally, this disqualification period is pro-rated, which means that each day that passes following the transference of such property to the irrevocable trust, serves to protect another portion of the asset. In other words, there is no down side to getting your Medicaid ineligibility clock running as soon as possible

However, on February 8, 2006 new Federal legislation was enacted which will prevent this Medicaid ineligibility period from beginning to run until such a time as to you were to enter a nursing home and apply for Mass Health benefits. Nevertheless, the new legislation does provide that your home will be protected from the costs associated with long term care provided you do not apply for Mass Health benefits for five years following the date you transfer your home to the irrevocable trust mentioned above, regardless of the value of the assets transferred. It is important to note that this new legislation does not prevent people from planning it simply makes protecting your assets a longer process. In other words, procrastination is now an even bigger problem than it used to be. However, there still remains no downside to getting your 60 month look back period running sooner rather than later.

However, there does remain a chance that you will be grandfathered in under the old rules as Massachusetts has not yet created regulations adopting the Federal legislation and may still be following the old rules for an undetermined period of time. Nevertheless, the Medicaid ineligibility period calculated above may still be beneficial in the event you were to enter a nursing home prior to the expiration of five years from the date of transfer as such period may still be less than the balance of time remaining on the original 60 month period.

**How to Insure That the Spousal Impoverishment Rules
Do Not Bankrupt the Healthy Spouse When One Spouse is Institutionalized,
Even Though No Advanced Medicaid Planning Has Been Done.**

Facts:

Husband and wife have a combined countable assets worth approximately \$600,000, consisting of a home worth approximately \$300,000 and miscellaneous other investments and/or cash worth in total approximately \$300,000. The wife is age 79 and the husband is age 83 and they have three children and three grandchildren. Husband suddenly takes ill and is admitted to a nursing home.

Issue/Problem:

Is it possible to save all of these assets for the healthy spouse so she may continue to live her life in the standard of living she was used to prior to her husband's admission to the nursing home.

Analysis/Solution:

Upon admission to the nursing home, the state would take a snap-shot of the entire family's assets and would award the home to the health spouse as long as she is residing there and then would proceed to divide the \$300,000 worth of investable assets in half allocating up to \$99,540 of such assets to the healthy spouse and awarding the entire balance totaling \$200,460 to the institutionalized spouse.

The estate would then deny Medicaid benefits to the institutionalized spouse indicating that they have \$200,460 and, until that is spent down to only \$2,000, the institutionalized spouse would be denied Medicaid benefits. At this time, the health spouse should have the \$198,460 remaining at risk transferred to her own individual account and proceed to use such dollars to purchase a Medicaid qualified annuity. This would be an irrevocable annuity that would guarantee the pay out of \$198,460 to the healthy spouse over her life expectancy, which, in this case, is approximately 10 years resulting in a monthly distribution of approximately \$1,654.

The purchase of this annuity is not considered a gift and, in fact, converts what was once a countable asset of \$198,460 into an income stream for the healthy spouse, thus leaving the health spouse with only the \$99,540 worth of allowable assets and immediately insuring the institutionalized spouse be approved for Medicaid benefits. Under the rules prior to the enactment of the Deficit Reduction Act of 2005, this also would have meant that upon the demise of the healthy spouse, any unpaid portion of such an annuity would avoid probate, continue the monthly payments to the designated beneficiaries (who are generally the children), but, most importantly, avoid any Medicaid estate recovery provisions as these assets pass outside the probate estate. In essence, all of the assets were saved for the benefit of the healthy spouse and the institutionalized spouse is immediately eligible for Medicaid.

This technique still appears to be a useful planning tool even under the new Deficit Reduction Act of 2005, but with a slight modification. Since the new act seems to require the state to be named as a remainder beneficiary it is important to make the term of the annuity as short as possible. By making the annuity term as short as possible helps to reduce the risk of there being any remainder left to go to the state as a remainder beneficiary. Either way this technique will still serve to ensure that at least the healthy spouse is not impoverished prior to his or her demise, and with proper additional planning may still save a larger portion of the assets for the next generation.

However, as mentioned above, the surviving spouse may only breathe a sigh of relief in knowing these assets have been spared from the costs associated with long term care as it may only be a temporary fix. At this point, in the event the wife were to get sick and need long term care, there is no healthy spouse available to live in the home, thus resulting in the house, the balance of the annuity payments, if any, and all of her other assets to be at risk for the costs associated with long term care, until there remains only \$2,000.

Therefore, her best approach would be to transfer her home and perhaps a portion of her liquid investments to the irrevocable income only trust mentioned above. This technique would insure that a shield be placed around any such assets transferred to the irrevocable trust, in which

she would retain control over the assets as indicated above, while insuring the proper disposition of such assets to her family following her demise. Most importantly, this technique will serve to protect any assets transferred to the trust associated with long term care once the expiration of the Medicaid ineligibility period has occurred associated with any such transfers.