

WILLMS, S.C.

LAW FIRM

TO: Clients and Friends of Willms, S.C.

FROM: Jessica A. Bourke

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RE: Irrevocable Trusts and Long-Term Care Planning

Introduction

Our firm often assists clients with creating and/or administering irrevocable trusts for a variety of purposes. Recently we have fielded a number of questions from our clients about irrevocable trusts and their impact on long-term care planning. In particular, the question raised is, "The assets in my irrevocable trust are disregarded if I need government assistance in paying for long-term care, right?" Sometimes the answer is "yes," but often it is "no."

Irrevocable Trusts and Estate Planning

Irrevocable trusts have long been used by estate planners as a method of removing assets from an individual's estate, thereby reducing the individual's potential to incur estate tax liability upon his or her death. In other words, you gift your assets now instead of leaving them to your heirs at your death. Unlike a revocable trust, where the grantors (the individuals contributing property to the trust) retain control over trust assets and can amend or revoke the trust during their lifetimes, irrevocable trusts constitute an irrevocable gift of assets to beneficiaries of the trust. Once the assets are transferred into the trust, the grantors cannot later decide to terminate the trust and "get the assets back." The purpose of an irrevocable trust in this scenario is to relinquish control over the trust assets, because doing so removes those assets from the estate of the grantor. The transfer of assets to the

trust is then either covered by the annual gift tax exclusion or lifetime gift tax exclusion, or is subject to gift tax. Then, because those assets are not part of the grantor's estate when the grantor dies, and because the transfer has already been subjected to gift tax laws, the assets are not subject to estate tax. This type of planning is particularly useful when individuals are concerned that the value of their assets may exceed the applicable estate tax exemption at the time of their death. These trusts are often funded with life insurance policies on the life of the grantors so that when the grantors pass away, the beneficiaries of the irrevocable trust (oftentimes, the grantors' children) receive the proceeds of the policies.

Irrevocable Trusts and Long-Term Care Planning

When clients come to us to discuss long-term care planning, they want to know what assets they can keep and still be eligible for government assistance if they need to apply for such benefits. Medicaid is the government program that assists individuals in paying for long-term care expenses. As most people know, the rules for Medicaid long-term care eligibility are quite strict in terms of the level of assets you can own. While a complete discussion of Medicaid eligibility requirements is beyond the scope of this article, suffice it to say that Medicaid does not allow an individual to retain a high level of assets.

However, if assets in an irrevocable trust are outside of a person's control and ownership, and therefore outside of their estate for estate tax purposes, doesn't that mean those assets are disregarded for Medicaid eligibility purposes? Unfortunately, that is not necessarily how the rules work. Instead the Medicaid rules say that if the assets of an individual (or their spouse) were used to fund a trust, and the individual is entitled to receive distributions of income and principal from the trust under *any* circumstances, then the entire trust is deemed an available asset for Medicaid purposes, and will likely make that person ineligible for benefits. This is true even if the individual who contributed assets to the trust has no ability to demand distributions, and even if the assets were contributed years ago, and even if the transfer was deemed a completed gift for gift tax purposes. There is no Medicaid divestment penalty (which applies when an individual tries to give away assets to

qualify for benefits) because Medicaid treats the trust assets as if they were never given away.

Example 1: John creates an irrevocable trust and places assets in that trust. A third party, not John, is the trustee. His children are named as the primary beneficiaries of the trust, but the trustee also has discretion to distribute income and principal from the trust to John's wife, Jill, if the trustee thinks it is necessary to do so. Neither John nor Jill retain any ownership over the assets in the trust, and they have no power to control how the trust assets are managed or distributed. The gift is complete for gift tax purposes and a gift tax return is filed. Ten years later, Jill needs to apply for Medicaid benefits to help pay for her long-term care. Because the assets in the trust were contributed by Jill or her spouse, and there are circumstances under which she could receive distributions from the trust, the entire value of trust income and principal is deemed to be owned by her, whether or not she ever receives any distributions, and the trust would count against what she can own and still qualify for government assistance.

Example 2: Same facts as in Example 1, except that the trustee only has discretion to distribute trust income to Jill, not trust principal. Now the trust principal is not counted against Jill when she applies for benefits, but the value of the income generated by the trust is deemed to be owned by her, whether or not any income is actually distributed to her.

Example 3: Same facts as in Example 1, except that the trustee does not have the authority to make any distributions to Jill from income or principal. In this situation, the trust income and principal may not be deemed to Jill by the Medicaid program. Instead, the Medicaid program would treat John's transfer as a completed gift, and if that gift occurred within five years of Jill applying for benefits, she would be subject to a divestment penalty. (In this example, the transfer happened six years ago, and

so the transfer may have successfully removed the trust assets from Medicaid consideration.)

Conclusion

Different planning goals require different types of planning. An irrevocable trust that is great for tax planning purposes may not be appropriate for long-term care planning purposes, and vice versa. The Medicaid laws that apply to irrevocable trusts are very strict, can be very complicated, and are frequently changed. However, there are ways to structure an irrevocable trust that will not prevent an individual from qualifying for government assistance in paying for long-term care. If you are concerned about paying for long-term care expenses in the future, and have an irrevocable trust that was not drafted with Medicaid eligibility as a goal, we would advise that you contact us to discuss what we can do to make sure that your estate planning documents are in line with your current goals.

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