Recent Challenges to Medicaid Trusts and How to Draft and Fund Them Properly Along with the Estate, Gift, and Income Tax Implications

Prepared by:
Todd E. Lutsky, Esq., LL.M Cushing & Dolan, P.C.
375 Totten Pond Road, Suite 200
Waltham, MA 02451
Phone: 617-523-1555
Fax: 617-523-5653
tlutsky@cushingdolan.com
www.cushingdolan.com

Introduction

The biggest question on the minds of elder law attorneys these days is, do we use Medicaid irrevocable income only trusts as a planning tool or not? It is no secret that across the country these trusts are being challenged by the states more than ever. That being said, recently there have been a series of cases and developments that acknowledge that these type of trusts are an acceptable planning tool to protect assets from the costs of long term care, provided however, that they are carefully drafted so as not to violate the federal or state laws governing these trusts. In addition, the *Hirvi* Settlement Decision requires MassHealth to adhere to specific tables for hearings and rehearings along with following prior fair hearing decisions so as to provide for administrative consistency. See Proposed Regulation 130 CMR 610.000 below. More specifically, if you have a denial for a certain trust provision and have an approval from another hearing officer on the same trust language, then MassHealth must grant a rehearing within forty-five (45) days.

However, the question remains, how does one draft these trusts to ensure they can withstand MassHealth scrutiny? Well, the answer to that question just became a whole lot easier to answer due to the state's issuance of Eligibility Operation Memo 20-04 on February 18, 2020, and the recent Supreme Judicial Court decision in the *Fournier* case. This Operation Memo explains that each trust will be analyzed separately but acknowledges there are a few commonly seen circumstances that make irrevocable trust assets countable. The memo provides a list of five such examples but also provides language that should be used in these situations to avoid having MassHealth treat the trust assets as countable under the any circumstances test.
These examples are as follows:

1. **Principal beneficiary:** The applicant and/or spouse is a principal beneficiary of the trust or can add himself or herself as a principal beneficiary.

2. **Power of appointment, special power of appointment, and/or limited power of appointment:** The applicant and/or spouse can appoint the trust principal to other individuals or entities, including to beneficiaries, and impose conditions or limitations on the receipt of the trust principal under such power of appointment. This power of appointment provision renders the trust principal countable unless there is language within the same appointment provision that completely prohibits the distribution to, or use of trust principal for, the benefit of the applicant and/or spouse in any way. In contrast, if there are only limited restrictions on the appointment power stating that the power cannot be used to discharge the applicant's and/or spouse's legal obligations, then the trust principal remains countable.

3. **Charitable or nonprofit organization:** The applicant and/or spouse can appoint the trust principal to charitable or nonprofit organizations. This power of appointment provision renders the trust principal countable unless there is language within the same appointment provision that completely prohibits the distribution to, or use of trust principal for, the benefit of the applicant and/or spouse in any way. In contrast, if there are only limited restrictions on the Appointment power stating that the power cannot be used to discharge the applicant and/or spouse's legal obligations, then the trust principal remains countable.

4. **Purchase of financial products:** The trustees can use the trust principal to buy financial products such as life insurance, long-term-care insurance, or endowment policies *for the benefit of the applicant and/or spouse*.

   It is important to note that the above list of trust paragraphs are most commonly challenged paragraphs by MassHealth. In fact, a large portion of this article will be exploring court cases and fair hearings dealing with all of these paragraphs and will explore how to defend your trust from such attacks. Thankfully, the Massachusetts Supreme Judicial Court recently dealt with power of appointment in *Fournier v. Sudders* 488 Mass. 43 (2021) and ruled that the power to appoint did not make the trust assets countable. Based on this decision, MassHealth decided not to move forward with their appeal on the same issue in the case of *Irene Brisebois vs. Marylou Sudders In Official Capacity as Secretary of the Executive Office of Health and Human Services*, Civil Action No. 1885-CV-01639 (September 9, 2019 Worcester Superior Court, Doolin, J.). While many of these cases and fair hearings end with the assets of the trust being considered non- countable for Medicaid eligibility purposes, the frustration has been that the state continuously brings up these same arguments even though they constantly lose. The good news is that the ruling in *Fournier v. Sudders,* Eligibility Operation Memo 20-04, and the *Hirvi* Settlement mentioned above, should stop the state from continuing to make these same arguments over and over again. This Operation Memo basically explains the language that should be used in these paragraphs and if so, MassHealth may not challenge the countability of the trust assets. It appears MassHealth is acknowledging court case decisions and fair hearings that have found such paragraphs not to cause the assets of the trust to be countable and is suggesting such language be used going forward. The downside of this Operation Memo is that the state is trying to use it as law to make trust assets countable if this language is not used but remember that such a memo is not law.

The balance of this article will explain the important paragraphs to use as well as the paragraphs to avoid when drafting these trusts, along with income, gift, and estate tax "do's and don'ts" when operating them during the donor's life.

Important Language Your Irrevocable Trust Must Have

Surviving spouse, Mrs. Public, age 75, established an income only irrevocable Medicaid trust in 2007, naming two of her children as trustees. (Note very similar terms would apply for a married couple with the only difference being that income would be payable to both the donor and the donor's spouse). She transfers a $1,000,000 investment portfolio and a $400,000 home into the trust and retained a life estate. She had acquired the home from the passing of her husband six months earlier. The trust provides as follows:

1) For so long as Mrs. Public is alive, income from the trust is payable to Mrs. Public.
2) Under no circumstances is the trustee permitted to pay to or use principal for Mrs. Public's benefit.
3) The trustee, in its discretion, may pay principal to or for the benefit of the class consisting of Mrs. Public's children of all generations.
4) Mrs. Public reserved, in the trust instrument, the right to appoint principal or income to or for the benefit of charities, other than charities that are also nursing homes or other medical institutions, of her choosing during her life. This is known as a limited power of appointment and is what makes the trust a grantor trust for income tax purposes.
5) Upon Mrs. Public's death, the property in the trust will be paid over to those persons selected from the class consisting of her issue and or non-governmental charities, in equal or unequal amounts, as designated in a Last Will and Testament referring to this power executed after the execution of the trust. This is known as a testamentary power of appointment.
6) In the event the power is not exercised, the property shall be sold, and the proceeds added to the balance of the trust assets and all trust assets to be divided into as many equal shares as there are children then living or children then deceased leaving children then living. In the case of a share allocated to a child such share will be paid out and distributed free of all trusts. In the event a child died then that child's share would be held in trust for that child's children rather than that child's spouse and such share will be held in trust for the benefit of those grandchildren until no such grandchild is under 30 years of age.

Planning Note: There are many different ways that one can leave assets to family members and are generally based on your particular family situation. For example, a continuing spendthrift discretionary trust can divorce-proof the trust and provide generation skipping tax benefits. See *Pfannenstiehl v. Pfannenstiehl*, 475 Mass. 105 (2016).

Current Status of Problematic Trust Provisions

1) **Purposes Clauses:** These are paragraphs that indicate that the trust is designed for a reason such as to provide for Donor to have as complete a life as possible and to ensure that the Donor's assets in the trust are to be used to keep the Donor in the community as long as possible. This type of language could cause the assets in the trust to be countable for Medicaid Purposes. The standard to determine if an asset is countable for Medicaid purposes is if there is "ANY CIRCUMSTANCES", regardless of how remote, that principal of the trust can be paid to the Donor then it must be paid and will be considered countable. Clauses

like this one make it appear that principal is available and thus may result in a denial for Medicaid benefits. While this clause alone may not cause the trust assets to be countable it nevertheless should not be a part of your Medicaid Irrevocable Trust. See *Cohen v. Comm's of Div. of Med. Assistance*, 423 Mass. 399, 406–407 (1996); *Doherty v. Dir. of Office of Medicaid*, 74 Mass. App. Ct. 439, 440 (2009).

2) **Termination Clauses:** These are clauses placed in the trust that generally allow the trustee under certain circumstances to terminate the trust and distribute the assets out to the beneficiaries. The problems with this type of language is that if all the trust assets can be distributed to the beneficiaries and there is no distinction made between the income and principal beneficiaries and the Donor is generally an income beneficiary, the Court will assume that the principal could be distributed to the Donor of the trust thus making the assets countable for Medicaid purposes. Again, if the principal can be paid to the Donor under "*any circumstances*" then it must be paid and will make the assets of the trust countable. See *Doherty, supra.*

   In a February 6, 2018 fair hearing, the state once again challenged a termination clause in a trust. The clause stated if in the trustee's discretion the trust becomes uneconomic or inadvisable to administer it could be terminated and paid out to the Donor's issue. The state said termination equaled revocation and since the trust is revocable the assets are countable. The hearing officer disagreed and stated that revocation means the Donor takes an action to get the assets back, but the Donor cannot take such action as the trust is irrevocable. While a termination by appellant/trustee can take place, assets would only go to children and not to the applicant and will not result in the assets going to the Donor but instead to the children. Therefore, the termination clause does not make the assets available for Medicaid eligibility purposes. See Fair Hearing No. 1717924. Best practice is to not have termination clauses in the trust.

3) **Trigger Language:** This language was popular before 1993, but these trusts still exist and were not grandfathered by the 1993 Medicaid legislation. This language generally states that during any period of time that the Donor of the trust is not eligible for Medicaid benefits then the trustee in its discretion can distribute principal to the Donor for his or her care or for health and medical expenses including nursing home care etc. Even though the trust may have stated that the trustee cannot distribute principal to the Donor in any other paragraph, the state will deny you Medicaid benefits because by not being eligible the principal of the trust can be paid out to you. This is certainly language that should not be placed in your Medicaid Irrevocable trust if you want to add certainty to the protection of your assets. More troubling, trusts drafted under prior law that included triggering language were not grandfathered once the updated law was passed. See *Cohen, supra.*

4) **Silence as to the Distribution of Principal:** This is when a trust is drafted that states that income can be distributed to the Donor during the Donor's lifetime but makes no mention as to whether principal can be distributed out to the Donor or not. This is likely to cause the state to take a closer look at the trust and then end up denying Medicaid benefits. There has been a recent fair hearing on this very matter and the state was successful in denying the applicant Medicaid benefits which resulted in the assets in the trust to be countable and at risk for nursing home costs. The state indicated that under the uniform trust code and coupled with the other broad trustee powers that the trust contained that if the trust does not prohibit the trustee from taking an action then that action can be taken. In this case since the

trust did not specifically prohibit the distribution of principal then it was determined that principal could be distributed. The prudent form of trust drafting must include a paragraph that specifically prohibits the distribution of principal to the Donor or the Donor's spouse under any circumstances. In fact, this may be the single most important paragraph in the trust. See Fair Hearing No. 1222688 dated August 5, 2014 (holding fiduciaries given power to distribute principal under broad powers of G.L. c. 190B, § 7-401, and so silence in trust allows distributions of principal).[1]

5) **<u>The Trustees Power to Lend Money to a Beneficiary:</u>** This type of paragraph can usually be found in the trustee power section of the trust. It might generally state that the trustee has the power to lend money to the beneficiary when and if reasonably necessary and with or without interest or security. The real problem with this is that the Donor of the trust is likely an income beneficiary and since the power granted to the trustee allows him to lend money to any beneficiary, the state will determine that there is a circumstance in which principal can be distributed to the Donor therefore the trust assets will be countable and at risk for nursing home costs. It is okay for the trustee to have the power to lend money but just not to the Donor. It would be prudent to make sure your irrevocable income only trust has a paragraph that specifically prohibits the trustee from lending money to the Donor or creator of the trust. See *Edholm v. Minnesota Dept. of Human Sers.* No. 27-CV-11-23237 (Minn. App. Ct. June 17, 2013, unpublished).

Planning Pointer: Eligibility Operation Memo 20-4 does provide language that allows principal to be loaned to the applicant or spouse without interest. It specifies that such a loan power would make the trust assets countable. Lending of trust principal to the applicant or spouse should be prohibited.

6) **<u>The Right to Redefine Principal as Income in a Reasonable Manner:</u>** The Uniform Principal and Income Act ("UPIA") was designed to allow the trustee to allocate Principal from investments to income so as not to limit investing options that may harm the income beneficiaries or vice a versa. This way the trustee would not be forced to invest in only income producing assets to help the income beneficiary while potentially hurting the principal or remainder beneficiaries and again vise a versa. The state has successfully persuaded hearing officers and Superior Court judges that this power permitted a distribution of principal to the Donor. The solution to this problem would be to put in the trustee power section of the trust a paragraph that states, notwithstanding the Massachusetts Uniform Principal and Income Act, the trustee shall have no power to allocate principal to income. Fortunately, this may not be necessary, because of *Heyn* v. Dir. of Office of Medicaid, 89 Mass. App. Ct. 312 (2016). In *Heyn*, the state argued that the trustee could sell the home in the trust and purchase an immediate annuity then allocate the payment of which are primarily return of principal to income and payout to the Donor/applicant. The Court did not agree and held that the power to allocate between income and principal did not cause the assets to be countable as such exercise is subject reasonable accounting standards and state law. Id. at 317–318. See also G.L. c. 203D, § 18(a) (creating presumption that additions to trust default to principal). See Fair Hearing No. 1509433 dated August 16, 2016 and Fair Hearing No. 1603241 dated October 21, 2016.

[1] General Laws c. 190B, § 7-401, was repealed when the Massachusetts Uniform Trust Code ("MUTC") was enacted. See St. 2012, c. 140, § 51. However, the MUTC provides for specific powers of the trustee that are substantially similar. G.L. c. 203E, § 816.

7) **The Right to Use and Occupy Real Estate:** In many of these trusts the Donor is given the right to use and occupy the home during the Donor's life. The state has argued that this power makes the home or other real estate "*available*" for the Donor and thus a countable asset and at risk for the costs of nursing home care. However, the rules governing these trusts indicate that only trust assets that are payable to the Donor can be countable or at risk for the nursing home costs. The state is challenging this type of language in trusts and so the solution is to simply make sure your trust does not have any such language. In Doherty, the applicant did not retain a life estate but had the right to use and occupy by the house by the terms of the trust, and this was one of the reasons the trust assets—i.e., the house—was countable. *Doherty*, *supra* at 441. In Fair Hearing No. 1200356, the hearing officer agreed with Cushing & Dolan's argument that the right to reside under the trust terms was akin to a life estate, and such a provision did not make the assets countable. See Fair Hearing No. 1516247 dated May 12, 2016. However, the Supreme Judicial Court of Massachusetts in the *Daley* and *Nadeau* cases has finally settled this matter once and for all. The Court ruled that the right to use and occupy a house does not give the trustee the ability to sell the house and pay out the principal and thus does not make the house payable to the Donor and is not a countable asset for Medicaid eligibility. The Court considered it a payment of income akin to rent and not a payment of principal. *Daley v. Secretary of the Exec. Office of Health and Human Sers*., 477 Mass. 188 (2017).

8) **The Right of Substitution:** This is generally a power that is put in that allows the Donor the right to withdraw all of the trust assets as long as they are replaced with assets of the same value. This is a power that is used to make the trust a grantor trust for income tax purposes. See I.R.C. § 675(4)(C). This is what would allow all of the trust income and capital gains to be reported on the Donor's personal income tax return so that he continues to pay the income tax at his lower rates just like before the trust was established. However, the state will interpret this to mean that the assets of the trust can be paid out to the Donor thus considered a countable asset. The solution to this problem is to simply not use this power in your trust document. You can accomplish the same favorable income tax benefits by using a limited power of appointment, which allows the Donor to appoint the income and principal to charities during his life, as mentioned above. However, the *Heyn* case mentioned above also indicated that this removal and replacement language would not make the assets in the trust countable for a Medicaid eligibility determination. The Court stated it would be no different than if a house were sold and replaced with money of equal value, the money would be no more countable than the house would be based on the terms of the trust. See *Heyn*, *supra* at 319 (right of substitution does not cause trust assets to be countable). See Fair Hearing No. Fair Hearing No. 1603241 dated October 21, 2016 and Fair Hearing No. 1908335 dated December 24, 2019. However, a recent September 15, 2017 MassHealth fair hearing has taken a new position on the use of this power to remove and replace trust assets with something of equal value. The hearing officer agreed with the state's argument that the Donor could transfer assets out to himself and put back into the trust a promissory note of equal value. The trust would receive the payouts and the Donor applicant would have use of the assets and therefore countable for Medicaid eligibility purposes. Since the trust would only be receiving payments back that would not violate any of the trustee duties not to pay principal to the Donor. See Fair Hearing No. 1614961 dated September 15, 2017. Query if the attorney argued that the assets the applicant received from the trust was not an asset at all but a liability if the result would have been different. Best practice remains not to use this power in the trusts.

9) **<u>The Right to Pay the Donor's Estate Tax, Estate Administration Costs, and Costs Associated with Last Illness:</u>** In these cases, the trustee granted the right to pay for any estate taxes due following the Donor's death or all costs associated with his last illness and/or as needed to close out the estate. The problem with this Power is that these expenses are generally large and would likely cause the trustee to be using principal of the trust for the benefit of the Donor. Any time principal can be used for the benefit of the Donor makes the trust assets countable. Furthermore, there are cases that state the cost of the nursing home was a cost associated with the Donor's last illness. This allows the state's estate recovery unit to force the access of trust principal to pay the bill. Thus, even if qualified for Medicaid benefits, the trust assets would be at risk for estate recovery purpose. This type of paragraph should not be a part of your trust. See In re Estate of Melby, 841 N.W.2d 867 (Iowa 2014) (trust assets countable because of ability to pay expenses of Donor).

10) **<u>Compensation of Trustees:</u>** In cases where the Donor of the trust is also the trustee, MassHealth may argue that the power of the trustee to compensate himself permits the distribution of principal to the Donor. Of course, this ignores the fiduciary principles of a trustee, as recounted in *Heyn* and *Doherty*, but nevertheless, best practice is to appoint a person other than the Donor as trustee and have language that allows the removal and replacement of the trustee but state that the Donor can never serve as trustee. See *Leger v. Comm's of Div. of Med. Assistance* Middlesex Sup. Ct. Civil No. 96-0768 (Sept. 3, 1998) (describing practice of Donor appointing self as trustee as unappetizing maneuver). There have been several fair hearing decisions in 2016-2017 that have stated that trustee compensation does not make the entire principal of the trust payable to the Donor. However, hearing officers have eluded to the fact that if the state could show what amount of compensation was reasonable that amount of assets could be considered available in a Medicaid eligibility determination. See Fair Hearing No. 1702593 dated October 27, 2017. The state has made this very argument in a recent fair hearing by arguing that a reasonable trustee fee would be approximately $4,000/year. However, this trust had around $600,000 in investable assets and I showed prior income tax returns demonstrating there would always be enough income to pay the trustee fee so that principal would never be so used or available. The only way it would not have enough income would be to put all the money into a non-interest-bearing checking account, which would in turn violate the trustee's fiduciary duty and the prudent investor rule which is not permitted. The hearing officer agreed that principal would never be needed, and the trustee compensation argument did not make the trust assets countable.

Finally, in an April 18, 2019 hearing decision, the hearing officer found that only reasonable compensation would be permitted. It was noted that only the "portion" of the corpus that could be paid would be countable and reasonable compensation does not allow all the corpus to be countable. Since the state asked for all without providing a reasonable number, then none of the corpus will be countable under this argument. See Fair Hearing No. 1818764 dated April 18, 2019 and Fair Hearing No. 1814034 dated May 14, 2019. These decisions are consistent with numerous other 2016-2017 fair hearing decisions. See also Fair Hearing No. 1601867 dated July 11, 2016, Fair Hearing No. 1509433 dated August 16, 2016,; Fair Hearing No. 1941657 dated September 12, 2019, and Fair Hearing No. 1942505 dated December 9, 2019.

11) **Limited Powers of Appointment:** Donors may reserve a limited power of appointment permitting the Donor to appoint principal to a class of beneficiaries generally defined as Donor's children of all generations. MassHealth has argued that this limited power causes the assets to be countable, as the Donor could appoint the assets to the beneficiary, who in turn could return the assets to the Donor. Massachusetts and New Hampshire have expanded their attacks to suggest that since the power to appoint allows conditions to be attached to the appointment that such a distribution can be conditioned on it or some portion of it being returned to the Donor. The states have also suggested that a Donor can threaten disinheritance through the exercise of a testamentary limited power of appointment if such distributed assets to the child are not returned to the Donor/parent or be used to pay for their care. Thankfully, Massachusetts Appeals Court in *Heyn* rejected the analysis, as the assets of family members (other than the spouse) are not considered when making eligibility determinations. See *Heyn*, *supra* at 318–319. In fact, the *Heyn* Court found that "a provision making trust principal available to persons other than the grantor does not by its nature make it available to the grantor, any more than if the grantor had gifted the same property to such person when she created the trust, rather than placing it in trust." Further, the Court noted that "for purposes of computing countable assets, Medicaid does not consider assets held by other family members who might by reason of love but without legal obligation, voluntarily contribute monies toward the grantor's support." *See Heyn, supra at 318-319).*

Further, the *Heyn* decision was applied in a February 6, 2018 fair hearing decision in which Massachusetts again argued that a distribution to a child from the trust could be made via a limited power of appointment with the attached threat of disinheritance if such assets were not returned to the Donor or used for his care. The hearing officer said the *Heyn* rational must apply here and that MassHealth should not consider as countable, assets held by other family members who might by reason of such threatened disinheritance, contribute monies toward appellants support. See Fair Hearing No. 1717924. Finally, the U.S. District Court, ND NY threatened disinheritance in *Verdow v. Sutkowy*, 209 F.R.D. 309 (N.D. N.Y., 2002) also dealt with this issue and held that absent of bad faith or fraud the decision of whether or not to provide Medicaid benefits should not be based on the remote possibility of collusion." 209 FRD 309 (N.D. N.Y. 2002). See also three New Hampshire hearings dealing with same issue. See New Hampshire Fair Hearing No. 2017-378 dated June 20, 2017, New Hampshire Fair Hearing No. 2016-846 dated August 21, 2017, and New Hampshire Fair Hearing No. 2017-235 dated April 27, 2018. See also Fair Hearing No. 1806566 dated November 14, 2018. Even a few recent 2019 fair hearing decisions are simply stating that the *Heyn* case has addressed this issue of this multistep transaction involving transferring assets to children and has essentially settled the matter by stating that such transfers to third parties do not make the underlying trust assets countable. See Fair Hearing No. 1818764 dated April 18, 2019 and Fair Hearing No. 1814034 dated May 14, 2019. These decisions also distinguish the trusts from the New Hampshire Supreme Judicial Court's decision in *Braiterman* by showing the specific language in *Braiterman* that allows the trustee to distribute principal to a child with the understanding or hope the child would return it to the parent, and how such language does not exist in these cases. See Fair Hearing No. 1902821 dated May 7, 2019, Fair Hearing No. 1814034 dated May 14, 2019, and Fair Hearing No. 1908335 dated December 24, 2019.

12) **Power to Appoint to Pooled Trusts:** MassHealth sometimes argues that the power to appoint to a charity runs afoul of the any circumstances test. Per MassHealth' s argument, such a provision allows the Donor to appoint to a pooled trust, which is a type of trust managed by a nonprofit organization that allows for certain payments back to the Donor of the pooled trust. After the Donor's death, the pooled trust must pay back the state, then between 10% and 20% goes to the sponsoring charity, and finally the balance is distributed to the family. This argument fails, because the pooled trust itself is not a charity, and the trust does not permit appointment to a non-charitable entity. There have been several, 2016 and 2017 MassHealth fair hearings in which the officer has concluded that a pooled trust is not a charity, and such an appointment cannot happen under this limited power of appointment as such exercise would violate the very definition of the limited power and thus the assets in those trusts were non-countable for Medicaid eligibility. See Fair Hearing No. 1601867 dated July 11, 2016 and Fair Hearing No. 1702593 dated October 27, 2017.

Finally, a couple of fair hearing decisions dated April 18, 2019 and May 7, 2019 further supported these conclusions by stating that a pooled trust is not a charity and the fact that a non-profit is trustee does not make the pooled trust a charity. Furthermore, the hearing officer indicated that the pooled trust is a grantor trust to be used for the applicant's benefit and thus could not appoint assets to it because it would violate the very terms of the trust. Finally, the hearing officer concluded that appointment assets to a pooled trust does not make the assets countable as there is no clear path back to the Donor. See Fair Hearing No. 1601867 dated July 11, 2016, Fair Hearing No. 1818764 dated April 18, 2019, and Fair Hearing No. 1902821 dated May 7, 2019.

13) **Power to Appoint to Charities:** The state's most recent and frequently targeted paragraph in 2019 has been the power to appoint to charitable nursing homes. The argument is that the Donor can move into a charitable nursing home, then appoint the assets there, and the nursing home would pay the bill of the applicant therefore using principal to benefit the Donor. However, recently the Massachusetts Supreme Judicial Court in the *Daley* and *Nadeau* decision remanded back to the hearing officer to consider the idea that assets that can be appointed to a nursing home that is a charity or non-profit, may be for the benefit of the Donor/applicant if the Donor is also residing in that nursing home. Since then, the Board of Hearings has reconsidered this idea on remand and has concluded that the limited power of appointment could not be exercised in that manner. Even if it could, there would be no evidence that the nursing home would use or would even be permitted to use the appointed money to pay the bill of the applicant. Therefore, no clear path back to the Donor and thus not countable for Medicaid eligibility. See Fair Hearing No. 1408634 remand dated March 5, 2018. Additionally, there is a January 29, 2018 Mass Superior Court case, *Sheryl Keddy v. MaryLou Sudders* addressed and resolved this very issue. The Court said that MassHealth's reliance on *Daley* regarding this issue is misplaced. The Court noted that the trust states that the limited power of appointment explicitly prohibits distributions to the applicant, her estate, her creditors, or creditors of her estate (i.e., a nursing home). Therefore, there would be no way or no circumstance in which the Donor or applicant could have used trust assets to pay the nursing home. See *Sheryl Keddy v. MaryLou Sudders*, Superior Court Civil Action No. WOCV2016-01500; See *Heyn, supra* at 318-319. Furthermore, there have been six fair hearings in 2018 by six different hearing officers, all concluding in one way or another that either the limited power could not be exercised in that manner or there is simply no clear path back to the Donor as the nursing home may not even be permitted to use the money in that manner. The following seven fair hearing decisions each by a different fair hearing officer,

but all of which concluded in one way or another that the exercise of a limited power of appointment to a charitable nursing home does not cause the assets to be countable in a Medicaid eligibility determination:

- August 2018, in Appeal No. 1715246, Hearing Officer Samantha Kurkjy found a power to appoint does not violate the any circumstances test, that a limited power of appointment cannot be exercised to benefit the applicant, and there is no path from a charity back to the applicant;
- March 2018, in Appeal No. 1408634, Hearing Officer Thomas Tonaszuck, on the remand from the Daley case found there was no clear path back to the Donor without violating the terms of the trust or applicable law;
- November 2018, in Appeal No. 1806566, Hearing Officer Rhada Tilva found that the Donor could not appoint the assets to benefit themselves and there is no obligation on a charity to use appointed assets to benefit the Donor;
- September 2018, Appeal No. 1812309, Hearing Officer Thomas Goode found that an appointment to charity can neither benefit the Donor nor come with restrictions placed upon the use of the monies, furthermore, a 501(c)(3) designated organization could not use contributions to benefit the Donor;
- June 2018, in Appeal No. 1802399, Hearing Officer Stanley Kallianidis, found that the Donor could not contract to have money given back to themselves and appointing to charities does not create a path back to the Donor;
- October 2017, Appeal No. 1702593, Hearing Officer Chris Jones found that an appointment to charity does not benefit the Donor and an appointment (even with a threat attached) does not make said monies countable for a Medicaid eligibility determination; and
- December 2019, Appeal No. 1942505, Hearing Officer Paul C. Moore found that an appointment to a nursing home conditioned to pay for the Donor's care would be a breach of fiduciary duty by the Trustee. Therefore, does not make assets of the Trust countable for a Medicaid eligibility determination.
- July 2, 2021, Appeal No. 2101487, Hearing Officer Marc Tonaszuck found that language forbidding distribution of trust principal to the Donor is not negated by any other Trustee's powers such as to appoint principal to a charitable organization or purchase insurance or any other instrument without the Trustee breaching his/her fiduciary duty to the remaining beneficiaries

Finally, and even more recently, The Massachusetts Supreme Judicial Court has ruled on this issue in *Fournier v. Sudders*, 488 Mass. 43 (2021) finding that "by definition a 'limited power of appointment' is a power that 'restricts to whom the estate may be conveyed; esp[ecially], a power by which the Donor can appoint to only the person or class specified in the instrument creating the power but cannot appoint to oneself or one's own estate.'" The Court held that "the Donor of the limited power of appointment, may not exercise the power for her benefit by appointing the trust principal to a permissible appointee, such as a nonprofit nursing home, on the condition that the trust principal be used to pay for [the Donor's] long-term care. As in Pitman, such an appointment would be motivated to benefit an impermissible appointee—in this case, both the Donor and the Donee of the limited power—and thus would be ineffective as a matter of law as a 'fraudulent exercise of [the] power.'"

The court in essence said that you cannot exercise a limited power of appointment under any condition if the exercise benefits an impermissible appointee. In this case the Donor of the trust or the applicant hold the power and they are not a permissible appointee. Therefore, they cannot appoint to a child if that child were to give the asset back to them. Therefore, the trust assets should remain non countable in these situations. Eligibility Operation Memo 20-04 also states that if you put language in the limited power of appointment paragraph that explains the exercise of the power can never benefit the Donor, then MassHealth will not treat the trust assets as countable under this paragraph.

14) **Use of Principal to Make Capital Improvements:** In a recent fair hearing dated September 15, 2017, the trust had language that allowed the Donor the right to use and occupy. It also allowed the trustee to pay principal to make capital improvements on the home. The hearing officer agreed that the right to use and occupy would not cause the home to be countable following the Daley Nadeau decision. However, since principal can be used to make capital improvements on a home that the Donor was residing in, then that would mean principal can be used to benefit the Donor and thus makes it countable for Medicaid eligibility determination. See Fair Hearing No. 1614961 dated September 15, 2017. Best practice is to not put such language in your trust. However, this author believes this case should have been appealed. The *Daley* Court states that if the home cannot be sold and principal paid out then the home and all its equity, arguably regardless of how many improvements were made to it, should not be a countable asset for Medicaid eligibility purposes.

15) **Deposit in a Continuing Care Retirement Community ("CCRC") – Is it a Countable Asset:** A recent fair hearing dated January 31, 2018 involved a married couple who entered a CCRC and made a deposit of $225,000 to the facility. Later, the husband moved to the nursing home wing while the spouse continued to reside in the independent living wing. The application was initially denied because the state argued that the $225,000 deposit was a countable asset. It turns out that there is no Massachusetts regulation on point, but a federal regulation exists. 42 U.S.C. §1396 (g)(1)(2). The hearing officer concluded 42. U.S.C. § 1396 (2)(B) is not satisfied. The only way the applicant could get the deposit would be if he and his community spouse were to die or leave the facility. The language of the contract is clear that if one spouse dies, one spouse continues to reside in the CCRC then the deposit is deemed to have been paid entirely on behalf of the survivor and to be used for the survivor's care. Again, demonstrating the only way to get the refund would be for the applicant to transfer out to a different facility and the community spouse to move out as well. Therefore, this would be an unattainable situation and thus the deposit is not countable for Medicaid eligibility purposes. See Fair Hearing No. 1718268.

16) **Valuation Limitations and the Caretaker Child Exception:** In a fair hearing dated September 1, 2017, the hearing officer had to address the issue of the value of a home transferring to a caretaker child. In this case there was no question that the child had lived with and cared for the parent/applicant for two years prior to her admission to the nursing home in accordance with 130 CMR 520.019(D)(6). The issue was the application of the home valuation limitation of $840,000 pursuant to 130 CMR 520.007(G)(3). This regulation indicates that if the home equity value exceeds $840,000 and no community spouse or disabled child is living there, then the individual is eligible for benefits. The home in this case was worth $951,700. The hearing officer ruled that the regulation 130 CMR 520.019(D)(6) allowing the transfer of a home to a caretaker child does not have any value limitation applied and MassHealth cannot place such limits that are not set forth in the regulations. Therefore, this transfer was permissible, and benefits were approved. See Fair

Hearing No. 1706269 dated September 1, 2017 and Fair Hearing No. 2007430 dated September 1, 2020.

Further, in Fair Hearing No. 2007430 dated September 1, 2020, there was a question as to whether a child needed to be the sole caretaker of the parent in the nursing facility. The Hearing Officer held that the caretaker child exception "also does not define 'provide care'", however, "there is nothing in 130 CMR §520.019(D)(6)(d) that implies that the caretaker child must be able to directly care for the nursing facility resident 24/7. A more sensible interpretation of that regulation suggests that the caretaker child must provide some acceptable level of care, which I find exists in this case.

17) **Right to Potential Future Income:** In a fair hearing dated February 6, 2018, the hearing officer had to address the issue of future potential income as a trust asset. The state argued that a home in a trust that allowed the applicant the right to live there should be generating rent. Mass Regulation 130 CMR 520.023(c)(1)(a) states that income from principal or income on corpus is to be treated as a countable asset or resource of an individual. Therefore, the value of all the rent over the life expectancy of the applicant should be imputed and treated as an asset. The hearing officer agreed that actual accumulated income would be an asset and must be paid out. This interpretation is consistent with 42 U.S.C. §1382b(e)(6)(B) which states, the term "corpus" means, with respect to a trust, all property and other interests held by the trust, including accumulated earnings and any other addition to the trust after its establishment (except that such term does not include any such earnings or addition in the month in which the earnings or addition is credited or otherwise transferred to the trust). This section also supports the conclusion that since any such trust earnings are not considered earnings of the trust in the month earned but are in the following months, that future assets or corpus of the trust cannot be considered an asset or corpus for MassHealth eligibility purposes. See Fair Hearing No. 1717924.

Finally, a recent April 19, 2019 fair hearing also agreed that only actual income earned by the trust would be countable and not potential income. However, undistributed but earned trust income could be deemed countable. See Fair Hearing No. 1818764 dated April 18, 2019.

18) **Purchase of Financial Products:** Some trusts have a trustee power to purchase life insurance on the life of the Donor, any beneficiary, and for the benefit of any beneficiary. This paragraph has been the state's newest challenge by basically arguing that the principal is being used to buy life insurance for the Donor and that the beneficiary can be the Donor. Therefore, principal is being used to benefit the Donor causing the assets of the trust to be countable for medical purposes. The fact is that the trustee can only buy life insurance or any investment in the name of the trust and not in the name of an individual. Life insurance is an investment that requires it to be on the life of an individual but owned by the trust. Finally, life insurance like a stock portfolio or a rental property are all purchased by the trust but for the benefit of the beneficiaries but only to benefit them in the capacity in which the trust allows. If your beneficiary is limited only to income, then that is all they can get from any trust investment, be it life insurance of a stock portfolio. There are several fair hearing decisions that demonstrate that this is a trustee power and that the trust would be the owner and the beneficiary of such a policy and that such a power does not make the trust assets countable. See Fair Hearing No. 1806566 dated November 14, 2018, Fair Hearing Decision No. 1941657 dated September 12, 2019, Fair Hearing No. 1942193 dated February 13, 2020, and most recently Fair Hearing No. 2101487 dated July 2, 2021.

As it relates to Fair Hearing No. 2101487, one of the most encouraging things about this decision is that the Hearing Officer in this case had previously held that the purchase of financial products for the benefit of any beneficiary made trust principal countable for the Donor. In this case, the same Hearing Officer stated, "language forbidding such a distribution [of principal] is not negated by any other Trustee's powers such as to appoint principal to a charitable organization or purchase insurance or any other instrument without the Trustee breaching his/her fiduciary duty to the remaining beneficiaries." This is encouraging as it appears that Hearing Officers are listening to facts on a case-by-case basis.

Finally, Eligibility Operation Memo 20-04 has even listed this power to cause trust assets to be countable. While there are some fair hearings that allow this trust power, we believe the best approach is to not give this power to the trustee.

How Do These Irrevocable Income Only Trusts Operate and What Can You Do and Most Importantly What Can You No Longer Do After These Trusts are Created and Implemented?

Question: Who would consider using these Medicaid irrevocable trusts?
Answer: While there is no hard and fast rule as to who can use these trusts, it is generally recommended to folks who have attained 60 years of age or older. In addition, you should consider using these irrevocable trusts if in fact one of your objectives in the estate and elder law planning world is to protect assets from the cost of long-term care. In the event this type of asset protection planning is not important to you, then a revocable trust would be the recommended vehicle for your estate planning needs. Finally, if you happen to be under age 60 but have a diagnosed mobility related illness, then of course you could consider the use of these irrevocable trusts as well.

Question: Who can be the Donor of these irrevocable trusts and what does that mean?
Answer: The Donor is referred to as the individual who creates the trust. The Donor may also retain certain powers over the trust, most importantly, the power to remove and replace a trustee at any time for any reason, provided, however, that the replacement trustee can never be the Donor of the trust. This retained power by the Donor allows the Donor to retain a significant degree of control over the operation of the trust, even though the Donor does not serve as trustee. In addition, the Donor will also be an income beneficiary of the trust.

Question: Who can be the trustee of these irrevocable trusts?
Answer: Often times, the Donor would like to serve as trustee of the trust thereby significantly increasing the Donor's control over the operation of the trust assets during the Donor's life. There is support for this position in Massachusetts where there is a case entitled *Ledger v. Department of Medical Assistance* in which the Court indicated that, while this may appear to be an unappetizing maneuver, it nonetheless fails to contravene any rule or regulation. However, there has since been another case known as the *Doherty* case in which the Appellate Court in Massachusetts indicated that the irrevocable trust was not drafted properly and provided too much control to the Donor, whereby causing the assets of the trust to be at risk. Therefore, it is the recommendation that the Donor does not serve as trustee and that the trust itself prohibits the Donor from serving as trustee.

Question: Do these trusts avoid the costs associated with the probate process?
Answer: An individual who passes away and owned assets in their own name, without a designated beneficiary, will subject all of those assets to the costs associated with the probate process. By establishing this irrevocable trust and, most importantly funding the trust with assets, will enable the assets that have been retitled to the name of the irrevocable trust to avoid the costs associated with the probate process. Always remember that if you just have a will this is the one document that must be filed with the Probate Court so if this is all the planning that you have done there is a good chance that you may not have even avoided probate. Finally, a will by itself will not help you reduce your estate tax liability or protect assets from the cost of long-term care.

Question: Do these irrevocable trusts protect assets from the costs of long-term care and how long does it take?
Answer: Once assets have been transferred to these properly drafted Medicaid irrevocable trusts; the assets will be protected from the costs of long-term care after the expiration of five years from the date of transfer. This is known as a five-year look back period for Medicaid eligibility purposes. This means that, from the date in which you would apply for Medicaid benefits, the state is entitled to look back at all of your prior transactions, bank accounts, investment accounts, etc., for the previous five years in order to see if there were any disqualifying transfers made during that period which would in fact prevent you from being eligible for Medicaid benefits. A disqualifying transfer is when a formerly available asset is transferred for less than fair market value to a place where it is no longer available for the nursing home. This same five-year waiting period applies even if the assets are just given to children and not to a trust. Once you have successfully made it beyond five years from the date of transfer to the trust, the state would then no longer be able to see such a transfer and therefore it would be protected from the costs of long-term care.

Planning Note House Bill 6300: Just a reminder, this five-year look back period is under review and the federal government is constantly exploring the idea of expanding it to be a 10 year look back period.

Question: How is the transfer penalty (or "period of ineligibility") computed?
Answer: To determine the penalty (or "period of ineligibility"), the value of the gift (in this case $1,233,964) is divided by the average daily cost of private nursing home coverage (also known as the adjustment divisor) on the date of application. 130 CMR 520.019(G)(1). For applications currently filed, the adjustment daily divisor is $427.00 (or $12,810 per month). In this case, the penalty would be 96.32 months ($1,233,964 ÷ $12,810).

Planning Note: Valuation of the remainder interest is accomplished by 130 CMR 520-019(I)(1). We compute the value of the remainder interest in the property for MassHealth purposes by multiplying the tax assessed value at the time of transfer, $300,000 by the remainder interest of .77988, to get a total transfer of $233,964. See below for calculation. By adding the value of the $1,000,000 in cash and securities transferred into the trust at the same time, a total transfer of $1,233,964 took place on the creation of the trust. If no retained life estate, then just use the real estate tax bill value for penalty period calculation purposes.

Question: When does the penalty begin to run?
Answer: For transfers occurring prior to February 8, 2006, the penalty begins to run on the date of the transfer. 130 CMR 520.019(G)(3). In this case, notwithstanding the fact that the penalty period of 8.02 years has not yet run, this transfer would be fully protected under the 5 year look back rules applicable to transfers into trust.

Planning Note: For transfers occurring on or after February 8, 2006, the penalty does not begin to run until the later of when the applicant is institutionalized and otherwise eligible. This basically means that the penalty does not begin to run until after the Donor is institutionalized and has less than $2,000. Therefore, YOU MUST WAIT 5 YEARS TO PROTECT ANY TRANSFERS.

Question: Which type of assets should a person retitle or transfer into one of these irrevocable Medicaid trusts?
Answer: A common asset that folks like to transfer to the trust would be their primary residence. It is also possible to transfer rental property or vacation property to these irrevocable trusts in order to protect them from the costs of long-term care. Finally, people also wish to transfer their non-qualified investment portfolios or a portion of their investment portfolios to these irrevocable trusts in order to protect them from the costs of long- term care. All of those types of assets can, in fact, be transferred to the irrevocable trust without any adverse income or gift tax consequences.

Question: What is the best way to deal with qualified plan assets and can they be transferred to these irrevocable Medicaid trusts?
Answer: First and foremost, IRA assets or any other qualified plan asset or retirement type asset, such as a 401(k) plan or a 403(b), should not and, in fact, cannot be transferred into these irrevocable trusts during life. In order to transfer one of these qualified plan assets into the trust, you would first need to withdraw the money from the qualified plan, thereby subjecting it to ordinary income tax liability and transferring only the amount net of taxes to the trust. Generally, this makes funding an irrevocable trust with such assets cost prohibitive.

The qualified plan type assets should now be used to live on during your life since the retirement plan assets would be outside the trust and therefore at risk for the costs associated with long term care. In addition, the recent implementation of the Secure Act has made leaving qualified plan assets to children much less attractive from a tax perspective. The old rule was that a child could withdraw the IRA funds annually over their lifetime. This allowed for many more years of tax deferred growth on those investments. The Secure Act, with a few exceptions would require the child to take the entire IRA out over a ten-year period of time. Under the Secure Act, if the participant dies before the required beginning date, currently 73 years of age, then there are no required minimum distributions required. However, waiting to take out all the funds in that last year would result in larger distributions pushing the beneficiary into much higher tax brackets than if the parents make the withdrawals during life and spend the money. If the participant dies after the required beginning date then the beneficiary must take RMDs over their life expectancy but must be emptied by the end of the tenth year following the death of the participant.

Question: What is the best way to set up designated beneficiaries for qualified plan assets from both a Medicaid and estate tax planning perspective for a married couple?
Answer: This is something that will ultimately be left up to the client after the attorney explains the pros and cons associated with each option. The general rule when you are dealing with a married couple is to make the primary trustee the spouse and the children as the contingent beneficiaries. This option would result in the best income tax payout by allowing the spouse to stretch withdrawals out over her lifetime and then allowing the children to take out over the new ten year payout.

<u>**Caution**</u>: However, if husband dies and leaves, say a $400,000 IRA to the spouse and then she goes into the nursing home later, the entire $400,000 IRA from husband is now at risk for the costs associated with nursing home care. Therefore, leaving the spouse as a beneficiary maybe good from an income tax perspective, but it may not be the best from a nursing home protection perspective.

Planning Note: IRA beneficiary the estate plus a testamentary trust: The alternative to naming the surviving spouse as the primary beneficiary on the IRA would be to name the estate as the primary beneficiary. This seems to fly right in the face of common tax sense as we have always been told that naming the estate is the worst way to go with IRAs. It is true that this approach will cause the IRA to go to probate and it will cause the IRA to distribute the assets over a five-year period, but only if the the participant was under 73 years of age otherwise under the secure act it would come out over the decedents ghost life expectancy. In other words it will come out of what ever age the decedent was at the date of death. This is generally not an issue as the surviving spouse and the decedent are generally close in age so it would not matter form a RMD perspective which life expectancy as used. This takes care of any adverse income tax issues. From an estate tax perspective, if you have a testamentary trust set up in the Will, then the IRA assets will be held in that trust in either the QTIP share or by-pass share for the benefit of the surviving spouse. When doing this be sure to use a fractional share funding formula for the QTIP trust to avoid income tax issues on the IRA going to the trust. This will allow the assets to be sheltered from future federal and state estate taxes. From a nursing home perspective, Medicaid Regulations 520.023 states that the trust rules and the transfer rules do not apply to trusts that are funded through a Will. This means that the testamentary trust can allow for discretionary distributions of both income and principle to the spouse without exposing those assets to the cost of nursing home care. In addition, since the transfer rules do not apply, that means there is no five-year waiting period to protect these assets. If the surviving spouse needed nursing home care, the husband's IRA, assuming he died first, would be immediately protected from the cost of long-term care. Therefore, by naming the estate as the primary beneficiary of the IRA, the surviving spouse has discretionary access to both the income and principle of the IRA and they are immediately protected from the cost of long-term care. These options must be explained to the client and let them decide which way to proceed by weighing the income tax consequences versus protection from the nursing home.

Finally, it seems clear that there are income and estate tax benefits as well as nursing home protection benefits associated with this approach to dealing with the IRA assets, However these benefits can be best explored through an example.

Example #1: Name the estate the primary beneficiary of the IRA coupled with a testamentary trust.

Facts: John Q. Public (74) and Mary Q. Public (72) own a home together worth $800,000. They each have individual retirement accounts worth $500,000 apiece and have joint bank accounts worth $100,000. They want to do both estate and Medicaid planning. They both established a Medicaid irrevocable trust and transferred one-half (1/2) of the house to their respective trusts. John passes away in 2023and has designated the beneficiary of his retirement account to be Mary Q. Public.

Estate Tax Perspective:
On John's passing, the total value of John's gross taxable estate will be $400,000 which is half of the value of the house owned inside his irrevocable trust. The $400,000 home will flow to the remainder share of the irrevocable trust and be included in his estate for both federal and state estate tax purposes. Since the federal exemption is currently $12,920,000

and the Massachusetts exemption is $1,000,000, there will be no estate tax due. If Mary were to die the next day, her estate would be $1,500,000 consisting of her half of the house, both her IRA and her late husband's IRA, and the joint bank account. There will be no federal estate tax due. Since the estate exceeds the $1,000,000 Massachusetts exemption, the state death tax will be approximately $50,000.

IRA, Income and Estate Tax:
The IRA will avoid the probate process and not be sheltered for estate taxes as it will pass directly to the surviving spouse, Mary Q. Public. Mary will then be permitted to take required minimum distributions ("RMD") over her life expectancy which will provide favorable income tax treatments.

IRA and Medicaid Nursing Home Perspective:
Mary will have complete access to the IRA assets. Since she has complete ownership of her late husband's IRA, if she were to enter a nursing home, those assets along with her own IRA would be at risk to be spent on her care.

Example #2:
Please note the same facts as the previous example only instead of naming the surviving spouse as the beneficiary of the IRA, John named the estate as the beneficiary of the IRA. They also added testamentary trusts to their Wills.

Estate Tax Perspective:
Upon John's passing, the testamentary trust will be funded with John's IRA and the assets funding the testamentary trust will go through probate as well as being included in John's taxable estate. The total value of John's taxable estate will be $900,000 which includes the value of his $500,000 IRA and one-half (1/2) of the value of the house which would be $400,000. Since John's taxable estate is under the $1,000,000 Massachusetts estate tax exemption, and way under the federal estate tax exemption of $12,920,000, there will be no estate tax due upon John's passing. In this case, the $400,000 home will be in the remainder share of John's irrevocable trust while the IRA will be in the remainder share of John's testamentary trust. Both of these shares will cause inclusion in his estate without creating an estate tax liability. However, most importantly, these shares will not be included in the estate of the surviving spouse. Assuming Mary passes shortly after her husband, her estate will the value of her $500,000 IRA, the $100,000 bank account and half of the value of the house which would be $400,000. Mary's total taxable estate would equal $1,000,000. Since there is a $1,000,000 estate tax exemption in Massachusetts and a $12,920,000 estate tax exemption federally, no estate tax would be due on Mary's passing. Thus, by naming the estate as the beneficiary of the IRA, coupled with the testamentary trust, results in a $50,000 estate tax savings along with income tax and Medicaid planning benefits to the explored below.

IRA and Income and Estate Tax:
Unlike Example #1, the beneficiary on the IRA in this example was the estate. This will cause the IRA to pass through the probate court but will end up in the testamentary trust. To understand the impact this arrangement has on the RMD's, one must look closely at the

Secure Act. The Secure Act statements that if you name the estate as the beneficiary of the IRA and the participant dies on or after the required beginning date of age 73 then the minimum distributions will come out over the ghost life expectancy of the decedent. In other words, the testamentary trust will receive the RMD's over the life expectancy of a 74 year old as that was John's age on his death instead of RMD's over a 72 year old's life expectancy that of Mary had she been named as the beneficiary. This slight difference would have only negligible income tax implications.

IRA and Medicaid – Nursing Home Perspective:
The testamentary trust not only helps to reduce the estate tax as shown above, but also provides a real benefit when it comes to both access to the IRA and protection from the nursing home. To better understand this, we need to look at the Medicaid Regulations. 130 CMR §520.023 states that the trust and transfer rules apply to trusts and similar legal devices that are created or funded other than by Will. This means that because the IRA is funding the testamentary trust through a Will, that the terms of the trust can allow discretionary distributions of income and principal to the surviving spouse and still not put the assets at risk for the nursing home. This is because the trust rules do not apply to testamentary trusts, thereby allowing significant access by Mary to the IRA assets of her late husband. In addition, since the transfer rules do not apply, that means these IRA assets are immediately protected from the nursing home without the need to wait five years. Therefore, if Mary were to enter a nursing home shortly after her husband died, these assets would be protected.

Question: Should the designated beneficiary of life insurance be these irrevocable trusts or the testamentary trust in a married couple situation?
Answer: The pros and cons of doing this should be explained to client and the client should make the choice. If you name the Medicaid irrevocable trust the beneficiary, then the asset avoids the probate process. These assets will however be added to the marital share or remainder share upon the death of the first spouse which will help to utilize both the federal and state estate tax liability. However, the surviving spouse will be able to directly access only the income from these assets.

Finally, the transfer upon death of the insurance proceeds to the trust would be a disqualifying transfer and create a five-year waiting period for the surviving spouse. Remember, transfers by either spouse are considered transfers by both of them as they are looked at as a single unit applying for Medicaid.

If you instead name the estate as the designated beneficiary of the life insurance policy, it will go through the probate process. However, that means that it will fund the testamentary trust built into the Will. This will allow death benefits to fund the marital share or remainder share so as to utilize the federal and state exemptions to reduce any estate tax liability, as mentioned above. These shares will be funded based on the size of the estate. The estate tax savings is the same regardless of which option you choose. However, Medicaid Regulation 520.023 provides that the trust rules and the transfer rules do not apply to trusts created or funded through a Will. This means that the surviving spouse will be a discretionary beneficiary of both the income and principle of the testamentary trust instead of only accessing the income. This provides increased access to the trust assets for the surviving spouse. In addition, since the transfer rules do not apply, the death benefit flowing to the testamentary trust upon the death of the insured does not create a five-year waiting period for the surviving spouse.

Therefore, if the surviving spouse entered the nursing home at any time after the death of the first spouse, the assets in the testamentary trust will be protected from the nursing home costs and saved for the family. If you named the spouse as the beneficiary, then you would avoid probate and provide complete access to the insurance proceeds to the spouse. However, the assets would be at risk for the nursing home and exposed to estate taxation upon death of surviving spouse.

Question: Is there a gift tax liability associated with transferring the investment portfolio and the home into these Medicaid irrevocable trusts and does a gift tax return need to be filed?
Answer: There are no gift tax liabilities associated with transferring assets to these irrevocable trusts because the gifts to these trusts are known as incomplete gifts for gift tax purposes since the Donor retains the right to designate the final beneficiaries of the trust in accordance with Treasury Reg. § 25.2511-2C. See also I.R.C. § 2511. In addition, no gift tax returns are required to be filed to report the transfer to the trusts, except if you wish to disclose the transfer to commence the running of a statute of limitations for auditing the gift. Treas. Reg. § 25.6019- 3(g).

A gift tax return should probably be filed, if only to provide full disclosure. If the Donor retained a provision in the trust rendering the gift incomplete, the regulations provide that a gift tax return should be disclosed on a return, but a failure to file would not render the taxpayer subject to any penalties or gift tax. In most cases, no gift tax return would have been filed. The risk is that the transfer was not incomplete and gift tax would have been due giving rise to penalties. Under Treas. Reg. § 25.6019-3(a), "[i]f a Donor contends that his retained power over property renders the gift incomplete and hence not subject to the tax as of the calendar quarter or calendar year of the initial transfer, the transaction should be disclosed in the return for the calendar quarter or calendar year of the initial transfer and evidence showing all relevant facts, including the copy of the instrument of transfer, shall be submitted with the return.

Planning Note: If the Deed transferred the real estate to a child and the Donor, Mrs. Public, reserved a life estate, there would have been a completed gift, which would need to be reported since the grantor did not reserve the right to designate the final beneficiaries. In addition, if the $1,000,000 in cash and marketable securities had been transferred to a child, a gift tax return would have been needed since the total gifts would have exceeded the current $17,000 present interest exclusion even though not in excess of the gift tax exemption for 2007.

Question: How do you compute the amount of the gift for gift tax purposes if the transfer of the real estate had been to a child rather than to a trust?
Answer: Assume the 7520-rate applicable for the date of the transfer was 2.4%. Using

Table S, single life factors based on Life Table 90CM with interest at 2.4%, the life estate portion is worth .22012 and the remainder interest is worth .77988. Therefore, to compute the value of the gift, you would multiply the fair market value of the property of $400,000 by .77988 ($311,952).

Question: What is the value of the transfer of the real estate for MassHealth purposes?
Answer: Pursuant to a new MassHealth Eligibility Operation Memo 19-12 effective September 3, 2019, the rates for calculation of the life estate and remainder are very different as they no longer look to the interest rate in effect for date transfer and simply use a unisex table provided under the Social Security Program Operations Manual. The difference, however, would be to use the assessed value rather than fair market value pursuant to MassHealth Regulation 103 CMR 520.007(G)(3)(a). The value of the transfer for MassHealth purposes will be $300,000 multiplied by .47851 ($143,553).

Planning pointer: Currently there is a new Masshealth operation memo being prepared that will eliminate the 19-12 memo above and establishing once and for all that when calculating the life estate and remainder values that you should use the IRS table S as shown above and not the social security POMs tables. However, I left the old version in here until we actualy see the new memo released as it had not come out as we went to press.

Question: What is Mrs. Public's basis in the property assuming the property was purchased for $40,000 in 1970?
Answer: $400,000 as a result of IRC § 2040(b) and *Gallenstein v. United States*, 92-2 USTC, P60,114 (Ed. KY 1991), aff'd 975 F.2d 286 (6th Cir. 1992). See, also *Patten*, 97-2 USTC, P60,279 (DC CA 1996), and *Anderson*, 96-2 USTC P60,235 (DC MD 1996). This Code Section and these cases stand for the proposition that, as to property acquired by a husband and wife prior to 1977, 100% of the property would be includible in the estate of the first spouse to die. There will be no estate tax because of the unlimited marital deduction, and the surviving spouse would have a full step-up in basis in the property.

Planning Note: If the property had been acquired after 1976, the surviving spouse would have a basis equal to $220,000, determined by adding one-half of the purchase price ($20,000), and one- half of the value on the date of death ($200,000).

Planning Note: It has been suggested that, notwithstanding this well-established rule, if the spouse who dies first did not contribute to the purchase price because the deceased spouse was a homemaker, for example, then the surviving spouse would receive no step-up in basis (and not even one-half). This does not seem to be supported by the Regulations. Regulations 20.2040-1, joint interests, (a)(2) provides: "The entire value of jointly held property is included in a decedent's gross estate unless the executor submits the facts sufficient to show that property was not acquired entirely with consideration furnished by the decedent…" This provision suggests that an election is available to the executor rather than any mandatory rule. There is no case directly on point.

Question: What is Mrs. Public's basis in the property for Massachusetts income tax purposes if different from the federal basis?
Answer: This depends upon when the first spouse died. The governing case is *Treat v. Commissioner*, 52 Mass.App.Ct. 208, 201. The Treat case involved a spouse who died in 1993, several years before Massachusetts completed the repeal of its estate tax system. Dealing with a 1993 death, the Appeals Court relied on General Laws Chapter 65C, §1(d), which is applicable to deaths occurring before January 1, 1997. This section provides:

notwithstanding Section 2035 of the Code, the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has, at any time made a transfer, relinquished the power or exercised a released a power of appointment, except in case of a bona fide sale for adequate and full consideration in money or money's worth, by trust or otherwise, during the three year period ending with the date of the decedent's death, provided however, the value of such property or interest therein so transferred or subject to the power so relinquished, exercised, or released, exceeds $10,000 for any person during the calendar year; and (2) notwithstanding Section 2040 of the Code, one-half of the value of any interest in any property shall be included in the gross estate of such interest is held by the decedent and the decedent's spouse as tenants by the entirety or joint tenants with rights of survivorship, but only if the decedent and the spouse of the decedent are the only joint tenants."

This section does not apply to decedents who died on or after January 1, 1997. Under current law, the Massachusetts estate tax, and by implication the definition of gross estate is based upon the federal estate tax credit pursuant to IRC § 2011. As a result, the surviving spouse should acquire a full step-up in basis for Massachusetts income tax purposes, provided the decedent died on or after January 1, 1997. Therefore, in this case, since the decedent died after January 1, 1997 a full step-up in basis will apply in Massachusetts as well.

Question: What would Mrs. Public's basis be if she had transferred the real estate to her children and not retained a life interest in the property, but continued to occupy the property as though she owned it and paid all expenses? None of the children reported any income attributable to rent.
Answer: In such a case, the decedent would have acquired a step-up in basis equal to the fair market value of the property on the date of death.

In the *Estate of Guynn*, 437 F.2d 1148 (4th Cir. 1971), the Circuit Court of Appeals ruled that where the Donor and the Donee are other than a husband and wife, such as a transfer of a home from a single parent to a child, then the IRS could successfully assert an argument that there was an implied life estate under IRC § 2036. See also, Rev. Rul. 70-155, 179-1CB 189.

Also, in *Estate of Maxwell*, 98 T.C. 39 (1992), the Tax Court ruled that the value of a decedent's former home should be included in the decedent's estate, even though the decedent "sold" the property to a child for $270,000, required payments of interest only at 9% per year (no principal was required), the decedent's Will forgave the Note at death, and the decedent cancelled $20,000 in a Note each year. The problem was that the decedent did not move out of the house and the Court found that an implied agreement to use and occupy the home existed under IRC § 2036(a).

On the other hand, in the *Estate of Powell v. Commissioner*, 63 T.C.M. 3192 (1992), the decedent transferred approximately 60% of his ownership interest in his principal residence to his children and their relatives. The decedent died owning 40%. The decedent continued to live in the home until he was forced to move because of his physical condition. The decedent paid all expenses, including real estate taxes, maintenance, and upkeep. The IRS unsuccessfully argued that the decedent retained a life estate under IRC § 2036. The Tax Court disagreed with the IRS's arguments finding that his continued occupation of the residence was consistent with his ownership interest as a tenant in common with his children. See, also *Estate of Wineman*, 79 T.C.M. 2189 (2000), 24% of the property gifted more than 20 years before death held not includible.

Question: Who is responsible for paying expenses attributable to the property after the property is transferred to the trust subject to a life estate?
Answer: The life tenant is responsible for paying all expenses associated with ownership, with the exception of capital improvements. This means that the life tenant would be paying property taxes and will be entitled to an income tax deduction with respect to such payments. If the property was rental income, then the rental income would simply be reported by the life tenant on Mrs. Public's Form 1040. A remainderman owes no duty of care to the life tenants, absent a duty voluntarily assumed by the remainderman. *Delprete v. Ferrante*, et al, L.W. No. 16-106, Judge King, Suffolk County No. 90-2152B.

Question: Can I continue to live in my home after it has been transferred to one of these Medicaid irrevocable trusts?
Answer: Yes, and you do not need any special language in the trust stating that you are permitted to live there the rest of your life or to use and occupy the property. To ensure you have this right you may consider retaining a legal life estate in the deed transferring the property to the trust. See *Heyn v. Dir. of Office of Medicaid*, 89 Mass. App. Ct. 312, 313 n.3 (2016), and the *Daley* case both discussed above. This will give you the right to live there, among other things, for the rest of your life. If the trustee tried to sell the home, he would now need your signature. Plus, you as Donor retain the right to remove the trustee.

Question: Can the home be sold after it has been transferred to one of these Medicaid irrevocable trusts? How does it work?
Answer: Yes, you can sell the home after it has been transferred to the irrevocable trust. The trustee of the irrevocable trust would sign the purchase and sale agreement in order to complete the transaction. Selling the property from the irrevocable trust in no way complicates the transaction nor adversely impacts the buyer. Upon completion of the transaction, the buyer would cut a check made payable to the trustee of the irrevocable trust who then would in turn deposit the check into a bank account that is established in the name of the irrevocable trust. It is important to ensure that the Donor does not receive the money personally, but instead the money is transferred directly into the irrevocable trust bank account so as not to restart the five-year waiting period. Finally, the house can be sold any time after it is transferred to the trust, even if it is during the initial five-year period from the date of transfer.

Question: Does the sale of a home from the irrevocable trust reset the Medicaid five-year look back period?
Answer: The five-year look back period is unaffected and, in fact, not reset by the selling of a home from the irrevocable trust, since nothing new was placed into the trust. The five-year look back period starts to run on the day an asset was transferred from an individual's own name into the irrevocable trust and not the day the trust sells the property.

For example, if the Donor establishes an irrevocable trust and transfers the property into the trust on January 1, 2015, and then, on January 1, 2018, the trustee of the trust sells the property and in exchange the trust receives the proceeds, which are promptly deposited into the irrevocable trust bank account, that transaction will have no impact on the initial five-year waiting period that began on January 1, 2015 when the home was transferred to the irrevocable trust.

In other words, the proceeds from the sale of the home, which are now deposited in the trust, will be protected from the cost of long term care in two more years, which represents the balance of the number of years remaining from the initial transfer of the home to the trust on January 1, 2015. Again, since nothing new was placed into the trust, there is no new five-year waiting period created. In this case, the trustee simply reinvested the assets that were already inside the trust from real estate to cash or any other investment of the Donor's choosing.

Question: Can the trustee of the trust use the proceeds from the sale of a home to purchase a new home inside the trust?
Answer: Once the irrevocable trust receives the proceeds from the sale of the home and are deposited into the trust bank account, the trustee may invest those assets in any manner the trustee deems fit. In other words, the trustee may simply write a check to the seller of a home that you are interested in purchasing and the seller will prepare a deed transferring the property to the trustee of the irrevocable trust. Once again, this transaction of purchasing the home inside the irrevocable trust does not reset the five-year waiting period.

As a practical matter, when one spouse passes away, it is not uncommon for a surviving spouse to downsize and sell the old primary residence and convert it to a condominium or some other downsized home. This transaction is completely permissible within the terms of the trust and again would not reset the five-year waiting period for Medicaid eligibility purposes.

Question: Assuming the property was sold on September 3, 2019 for $600,000, what are the income tax and MassHealth consequences?
Answer: Income Tax Consequences – In order to sell the property, Mrs. Public, as well as the trustees of the trust, would need to sign the deed. Since the life estate is a property interest, a portion of the proceeds would need to be paid directly to Mrs. Public and a portion would need to be paid directly to the irrevocable trust. The amount to be paid to each party is determined based upon the Table S using the 7520 rate in effect on the month of the sale. Basis in the property is similarly allocated.

Cash and the gain are allocated based upon these percentages. That portion of the sale proceeds allocated to the life tenant will be eligible for the capital gain tax exclusion under IRC § 121. As a single person who owned and occupied the residence as her home for two out of the last five years, she would be able to exclude up to $250,000 in capital gain. The balance will be taxable at 15% and 5% (Massachusetts). Revenue Ruling 71-122. The portion of the proceeds allocated to the trust may or may not be taxable depending upon whether the trust is a grantor trust. If the property had been deeded to the child instead of the trust, the portion of the proceeds allocated to the child would be taxable as capital gain with no exclusion since the child did not live in and own the home for two of the last five years.

If the trust is a grantor trust, the trust must file Form 1041, identify itself as a grantor trust, and send a tax letter to the grantor informing the grantor that the grantor is responsible for reporting the trust's portion of the gain. In this case, the total gain is $200,000 ($600,000 - $400,000).

Assuming the same 7520 rate of 2.2%, the life estate portion is 10.881%, which means $21,762 would be included, but the remaining $178,238 would be reported by the remaindermen. If the remaindermen are the children, it would be fully taxable at capital gain rates. If the remainder portion was owned by a grantor trust, then that gain would be reallocated to the grantor and eligible for the capital gain tax exclusion making the full $200,000 income tax free. Rev. Rul. 66-159 and Rev. Rul. 85-45.

As a result of the sale, a 1099-S will be issued to either Mrs. Public or her irrevocable trust, or both depending upon whether or not Mrs. Public directs the closing agent to issue separate 1099s (one to Mrs. Public and one to Mrs. Public's Irrevocable Trust) in order to reflect the appropriate percentage of the gross proceeds allocated to her (as the holder of the life estate) and to her trust (as the remainderman).

MassHealth Consequences: Sale of a life interest is governed by 130 CMR 520-019(I)(2). "If the nursing facility resident's . . . life estate interest or property including the life estate interest is sold or transferred, the value of the life estate interest <u>at the time of the sale</u> (emphasis added) or transfer is calculated in accordance with the Life Estate Tables as determined by the MassHealth agency. The MassHealth agency will attribute the value of the life estate interest at the time of the sale or transfer to the person selling or transferring the life estate."

The portion of the sale proceeds allocated to the life tenant becomes a countable asset, which is now governed by a new unisex table pursuant to Eligibility Operation Memo 19-12 which is effective September 3, 2019. In this example, Mary Public would now be 87 years old as of September 2019, the date of sale and the new table indicates that the life interest is worth $193,572 ($600,000 x .32262). If the grantor is in a nursing home, to the extent the life tenants share of the proceeds together with other assets exceed $2,000, as is the case here, the applicant would be disqualified from MassHealth benefits unless further action is taken, such as an annuity or the use of a pooled trust.

Planning Note: Prior to the issuance of the September 2019 Operation Memo, the portion allocated to the life estate was determined by IRS tables for the application federal rate in effect for the month of transfer. If these tables were used, the value of the life estate would have only been $59,874 ($600,000 x 9.979%). This new Operation Memo is causing a big problem for tax practitioners. In this regard, different tables provide very different for income tax purposes and Medicaid countable asset purposes. Again as indicated above there is a new operation memo being drafted to eliminate the 2019 memo and indicate that Masshealth will follow the federal tables for life estate and remainder calculations. This left in until we actually see the new memo.

Planning Note: This is probably the biggest disadvantage to retaining a life estate. In this case, the $193,572 value of the life estate interest would be allocated to the grantor disqualifying the grantor from receiving benefits. If instead of reserving a life estate the property had been transferred by fee simple interest into the trust, no portion of the sale proceeds would need to be reallocated to the grantor and the entire sale proceeds would be protected from MassHealth and the taxpayer would not have to pay any capital gain because the gain, even though realized by the trust, would be reallocated to the grantor for income tax purposes and it would be eligible for the capital gain tax exclusion under IRC § 121.

Question: Can I transfer rental property into one of these Medicaid irrevocable trusts and, if so, what are the tax and operating implications?
Answer: Rental property can be transferred to these irrevocable trusts and there would be no adverse tax implications of doing so. Remember, like the primary residence, this rental property can be sold, and the proceeds can in fact be used to purchase another piece of property at any time during or after the five-year look back period. There would also be no adverse income tax consequences associated with any such sale. In other words, you would continue to pay all of the same capital gains taxes associated with the sale of rental property out of the trust as you would if you had sold the property from your own name.

Question: After rental property has been transferred to a Medicaid irrevocable trust, how is the rental income generated handled and who receives it?
Answer: These Medicaid irrevocable trusts are designed as income only grantor trusts, which mean that the trustee is obligated to pay out the income earned by the trust to the Donor and remember rent is income. In this regard, the tenant would write a check for the rent and make it payable to the trustee of the irrevocable trust. The trustee of the irrevocable trust must have established a checking account in the name of the irrevocable trust under its own tax identification number in order to deposit this rent check into the trust checking account. The rent check represents trust rental income in which the trustee is then obligated to write a check out of the trust checking account payable to the Donor of the trust, who in turn will deposit that check into his or her own personal checking account. You can also set the trust account up in a way that will automatically transfer the rental deposits to the Donor's personal checking account to be used as desired, which means the trustee does not need to be involved in these transactions.

In other words, the rental income will end up in the Donor's personal checking account through this two-step approach instead of directly, which is where the rental income use to go prior to the rental property being transferred to the irrevocable trust. The Donor is then free to spend that rental income on anything he or she desires, just like before the establishment of the trust.

From a liability perspective, it may be advantageous to transfer rental properties into LLCs. In the event that a tenant or guest is injured in the rental properties, the existence of the LLC will help protect your personal assets from being taken in satisfaction of a legal judgment against you.

Question: Do these Medicaid irrevocable trusts have to file separate income tax returns and, if so, does that result in an increased income tax liability?
Answer: These trusts are considered grantor trusts and should file an income tax return, but all the elements of income, deductions, credits, and the like should also be reported on the grantor's return. I.R.C. § 674(a) causes the trust to be a grantor trust if the Donor retains the power to appoint principal and income during his life. In this trust, Mrs. Public can appoint both to charities, so it is a grantor trust. It is also important that the trust obtain a separate tax identification number for this purpose. However, since the trust is a wholly owned grantor trust for income tax purposes, as described above, the trust will effectively not pay any separate federal income taxes. Instead, this grantor trust status causes the Donor to be treated as the owner for income tax purposes and essentially flows the income through the trust and causes it to be reported on the individual Donor's income tax return, Form 1040, just like it used to be done prior to the establishment of this irrevocable trust. Therefore, these Medicaid irrevocable trusts are known to be income tax neutral, resulting in no increase or decrease in income tax liability to the Donor. The Donor will continue to pay the same tax as he or she did prior to the establishment of the irrevocable trust.

Question: If Mrs. Public did not sell and instead died owning it in the trust, would the trust assets receive a step-up in basis for capital gains tax purposes upon the death of the Donor?
Answer: Since the donor retained the right to the income under I.R.C. § 2036(a), the trust assets will be included in the donor's estate and will get a full step-up in basis upon the death of the donor. This step-up in basis rule can be important in reducing future capital gains tax liability associated with the sale of the property following the death of the donor. A step-up in basis means that the cost basis in the hands of the beneficiaries following the death of the donor would be equal to the fair market value of the asset received as of the date of the donor's death. Therefore, if the beneficiaries of the asset were to sell it shortly after the donor's death, it would result in little to no capital gains tax liability to the beneficiaries.

For example, if Mrs. Public had purchased their home long ago for $50,000 and had approximately $50,000 of capital improvements during her lifetime, which would result in her cost basis of the property being equal to $100,000. Let us assume the Mrs. Public transferred this property to an irrevocable Medicaid trust and upon her death the property was worth $600,000. Upon her death, the beneficiary of this property would receive a cost basis equal to its fair market value of $600,000. If the beneficiary then sold the property for approximately $600,000, which is the fair market value, there would be no capital gains tax to be paid by the beneficiary.

This should be contrasted with individuals who opt to give away their home or other highly appreciated rental property to their children prior to their demise, as such a transaction would result in what is known as a carryover basis in the hands of the donee/beneficiary. A carryover basis means that the donee/beneficiary of the property transferred during life would be the same cost basis that it was in the hands of the Donor immediately prior to the transfer.

In our example, that would mean that the donee/beneficiary, the child, would have a cost basis in this real estate equal to $100,000. In the event the donee/beneficiary sold the property following the death of Mrs. Public, there would be a capital gain equal to $500,000 ($600,000 - $100,000) and assuming at 20% federal capital gains tax rate, a 5% state capital gains rate and applying the new net investment income tax rate of 3.8% that would result in a capital gains tax of approximately $144,000. The Medicaid irrevocable trust's ability to preserve this step-up in basis benefit is extremely important. This basis step-up would apply to not only real estate, but any investment portfolios or stocks transferred to the trust that may have appreciated over time. See I.R.C. §§ 1014, 2016.

Planning Note: It is important to remember that any net rental income generated from the property will be available to the Donor of the trust under the terms of the trust, and as such will also be available to the nursing home for MassHealth purposes.

Question: Do I have to sell my assets inside my investment portfolio prior to transferring them into the trust?
Answer: No. In general, the funding of an irrevocable trust does not result in any income tax related issues whatsoever. In other words, when a trust is funded, it generally means nothing more than retitling the existing assets to the name of the trust. If you have an investment account at Fidelity, you are likely to receive a statement from Fidelity and it generally comes in your name, which is indicated in the upper left-hand corner of the statement.

Once this Fidelity account has been successfully retitled to the name of the irrevocable trust, you, as Donor of the trust, will continue to receive these same statements from Fidelity with all the same investments listed on them, the only difference will be that the name of the irrevocable trust along with the trustee's name will appear in the upper left hand corner of the statement. Therefore, there is no adverse income tax consequences associated with retitling assets to the trust as nothing was sold prior to the transfer.

Question: How do I transfer real estate to the irrevocable Medicaid trusts and are there any adverse income tax consequences?
Answer: The funding of a trust with real estate is generally done through the preparation of a new Quitclaim Deed. The deed simply transfers the property from the individual name of the Donor to the name of the trustee of the irrevocable trust. The new deed and a trustee certificate will then be filed at the registry of deeds. There will be no adverse income tax consequences associated with this transfer nor is there any gift tax liability due.

Question: Are there any investment limitations on the trustee of a trust?
Answer: The trustee of a trust can invest in all of the same investment options that would be available to an individual and therefore are not limited by having the assets invested inside a trust. However, the trustee should follow the prudent investment rule as a guide towards making investment decisions. The only caveat, of course, is that there are no individual retirement accounts owned inside of an irrevocable trust as mentioned above.

Question: Can these irrevocable trusts be changed in any way after they are created and, if so, how?
Answer: While the trust is irrevocable, it nevertheless can be changed through the use of a limited power of appointment, as mentioned above. This is a power in the trust in which the Donor is granted the ability to change the beneficiaries of the trust but generally are limited to a class consisting of the Donor's children of all generations and charities but specifically excludes the Donor, Donor's creditors, Donor's estate or creditors of the Donor's estate. This power enables the Donor to retain a significant degree of flexibility to adjust their wishes as life events unfold after the creation of the trust. This power is a testamentary power of appointment and is only exercised through the Donor's Will following his death in which the Will references this power.

For example, a Donor may wish to leave a little more assets to grandchildren or perhaps may find that one child is doing extremely well financially while another child is struggling and may desire to reallocate the percentages in which the children are to receive assets, all of which can be done through the use of exercising this limited power of appointment. However, you cannot add a person as a beneficiary to the trust who was not already a member of the class of beneficiaries. The class of beneficiaries can be increased to include siblings or nieces and nephews or as needed to accommodate any family situation. Sometimes making the class larger when the trust is initially drafted may provide even greater flexibility later.

Question: Can I add assets to the irrevocable trust many years later?
Answer: Yes, assets can be added to the irrevocable trust at any time after the trust has been created. However, the addition of assets to the trust will result in the creation of a new five-year look back period, but the look back period will be associated only with those assets that were transferred. The creation of this new look back period for those newly transferred assets will in no way affect the look-back period for previously contributed assets. In other words, if you had contributed assets to the trust five years earlier and only now wish to put additional assets into the trust, the assets that were put into the trust five years earlier will remain protected from the cost of long term care and this new look back period will only apply to these newly added assets.

Question: Is it important to use one or two irrevocable trusts when doing this type of asset protection planning?
Answer: If you are single, then only one irrevocable trust would be needed. However, if you are married and the value of your assets exceed $1,000,000 in Massachusetts, $1,595,156 in Rhode Island or $7,100,000 if you live in Connecticut or may exceed any of these state exemption amounts over the balance of your lifetime, then you should consider

two irrevocable trusts. The reasoning behind two irrevocable trusts is to help you more fully utilize both of your federal and state estate tax exemption equivalent amounts, thereby serving to reduce your estate tax liability. In other words, these Medicaid irrevocable trusts can also help you reduce your estate tax liability while serving to protect your assets from the cost of long- term care at the same time. A discussion on the reduction of your estate tax liability and how the trusts are designed to accomplish that is beyond the scope of this letter.

Question: Can the Donors borrow against any real estate that has been transferred to the irrevocable trust?
Answer: Once real estate has been transferred to these irrevocable trusts, generally you cannot borrow against the property anymore. This is generally not a concern for many of the elderly folks who do this type of planning as they have paid off their mortgages and are not interested in going into debt anymore. In the event you happen to have an existing mortgage on the property but wish to transfer it into one of these irrevocable trusts, the transfer of the encumbered property will include the retention of a life estate and will not trigger the due on sale clause, but you will be prohibited from refinancing such debt. Therefore, it is important that any such encumbered property being transferred to the trust have a fixed rate mortgage for the life of the loan.

If borrowing against the property in the future is of importance to you, then it is recommended that you establish a home equity line of credit prior to transferring such property to the irrevocable trust. This will enable you to borrow against that equity line after the property has been transferred to the trust. Once the equity line expires, however, you would not be able to renew it.

Conclusion:
One thing is clear, that the scrutiny of these Medicaid irrevocable income only trusts will continue. However, it is equally clear that the effectiveness of these trusts will be based upon the language used in drafting them. Nevertheless, these trusts remain an acceptable planning tool when it comes to protecting assets from the cost of long-term care.