Using Irrevocable Trusts To Qualify for Medicaid

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Medicaid Rules - Background

- Trusts established prior to August 10, 1993: COBRA '85 and the Medicare Catastrophic Coverage Act of 1988 (MCCA).
- Medicaid Qualifying Trust (MQT): a trust, or similar legal device:
- 1) established, other than by will, by an individual or individual's spouse
- 2) under which the individual may be the bene of all or part of the corpus or income
- 3) in which distribution of the corpus/income is determined by trustee(s) who are permitted to exercise any discretion with respect to such distributions

Medicaid Rules - Background

- If there is an MQT:

the amount from the MQT deemed available to the settlor/beneficiary for purposes of determining Medicaid eligibility is the maximum amount of payments (both principal and interest) that may be distributed to the settlor/beneficiary, assuming the full exercise of discretion by the trustee(s).

Medicaid Rules – OBRA ‘93

- Omnibus Budget and Reconciliation Act of 1993 (OBRA ‘93) eliminated MQT provisions and enacted new set of rules for both revocable and irrevocable trusts established after August 10, 1993.
- Under OBRA-93, "trust" is defined as including any legal instrument or device that is similar to a trust, but not including testamentary trusts. 42 U.S.C. §1396p(d)(6).

Medicaid Rules – OBRA '93

- An individual is considered to have established a trust if the individual's assets were used to fund all or part of a trust and if the trust was established by: (1) the individual; (2) the individual's spouse; (3) a person, including a court or administrative body, with legal authority to act in place of or on behalf of the individual or the individual's spouse; or (4) a person, including any court or administrative body, acting at the direction or request of the individual or the individual's spouse. 42 U.S.C. §1396p(d)(2).

Medicaid Rules – OBRA '93

- Apply only to the portion of the trust attributable to the individual and without regard to (1) the purposes for which the trust is established, (2) whether the trustees have or exercise any discretion under the trust, (3) any restrictions on when or whether distributions may be made from the trust, or (4) any restrictions on the use of distributions from the trust. 42 U.S.C. §1396p(d)(2).

OBRA '93 – Revocable Trusts

- The corpus of a revocable trust is considered a resource available to the individual, and any payments from the trust to or for the benefit of the individual are considered income of the individual.
- Any other payments from the trust to third parties are considered assets disposed of or transferred by the individual. 42 U.S.C. §1396p(d)(3)(A). Such payments to third parties may be subject to scrutiny under the transfer penalty rules.

OBRA ’93 – Irrevocable Trusts

- If there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the trust, including corpus and income, from which payment to the individual could be made is considered a resource available to the individual.
- Peppercorn test: “If there is a peppercorn of discretion, then whatever is the most the beneficiary might under any state of affair receive in the full exercise of that discretion is the amount that is counted as available for Medicaid eligibility.” Cohen v. Comm'r of Div. of Med. Assistance, 668 N.E.2d 769, 777 (Mass. 1996).

OBRA ’93 – Irrevocable Trusts

- Any actual payments from the trust to or for the benefit of the individual are considered income to the individual.
- If payments are made for any other purpose, they are considered a transfer of assets and may be subject to the transfer penalty rules. 42 U.S.C. §1396p(d)(3)(B).
- It is generally accepted that self-settled income-only trusts, in which the corpus cannot be distributed or invaded for the benefit of the individual, remain effective. The income will be deemed an available resource, but the corpus of such a trust will not.

OBRA '93 – Irrevocable Trusts

- Any portion of an irrevocable trust, including corpus and income, that cannot be distributed to the grantor shall not be counted in determining his or her eligibility for Medicaid.
- However, as of the date of establishment of such a trust (or, if later, the date on which payment to the individual was foreclosed), its corpus will be considered to be assets disposed of for less than fair market value and will be subject to the 60-month lookback period and transfer penalty rules. 42 U.S.C. §1396p(d)(3)(B)(ii).

OBRA '93 – Specific Trusts

- OBRA '93 also provides that an applicant's assets held by one of three specific types of trusts will not be included in determining his or her eligibility for Medicaid. These include:
- 1) Self Settled Special Needs Trust (d4A Trust)
- 2) Qualified Income Trust (Miller Trust)
- 3) Pooled Trust (d4C Trust)

OBRA ’93 – Specific Trusts

- Self Settled Special Needs Trust (d4A Trust):
- A trust containing the assets of an individual under age 65 who is disabled and that is established for the benefit of the individual by a parent, grandparent, legal guardian of the individual, or a court, if the state will receive all amounts remaining in the trust on the death of the individual up to an amount equal to the total medical assistance paid on behalf of the individual under the State plan. 42 U.S.C. §1396p(d)(4)(A).

OBRA '93 – Specific Trusts

- Qualified Income Trust:
- A trust composed of only the individual's pension, Social Security, and other income (and accumulated income in the trust), where the state receives all amounts remaining in the trust on the death of the individual up to an amount equal to the total medical assistance paid on behalf of the individual under the State plan. 42 U.S.C. §1396p(d)(4)(B).

OBRA '93 – Specific Trusts

- Pooled Trust (d4C Trust):
- A trust containing the assets of an individual who is disabled, where the trust is established and managed by a nonprofit association; a separate account is maintained for each beneficiary of the pooled trust funds; and the trust account is established solely for the benefit of the disabled individual by the individual, the individual's parent, grandparent, legal guardian, or by the court. To the extent that amounts remaining in the beneficiary's account upon the death of the beneficiary are not retained by the trust, the trust pays to the state an amount equal to the total medical assistance paid on behalf of the individual under the State plan. 42 U.S.C. §1396p(d)(4)(B).

Using Medicaid Trusts – Homestead Example

- Applicant may not have more than $2,000 in countable assets.
- The entire value of the home is excluded in determining resource eligibility, as long as:

1) The home is the principal place of residence for the applicant, spouse or dependent relatives; and

2) The individual intends to return to the home if the individual resides in a long-term care facility.

- An individual must have lived in the home for it to be considered her home or principal place of residence.
- For an institutional individual, the individual is ineligible for payments of long term services and supports (CHOICES) when home equity exceeds $552,000, unless one of the following lawfully resides in the individual's home:
  - the spouse of such individual;
  - such individual's child who is under age 21; or
  - such individual's child who is blind or disabled

Homestead Example – Estate Recovery

- However: the definition of "estate" for Medicaid estate recovery purposes is determined by each state, but must at least include the individual's "probate estate."
- This means that while some assets might be considered "exempt" when initially determining financial eligibility for Medicaid, many of those assets are still subject to estate recovery if they are in the individual's probate estate.

Homestead Example – Estate Recovery

- Even though Tennessee law dictates title to real property vests to the devisee at the death of the testator, this "does not necessarily mean that the real property cannot be subject to the probate proceedings in some circumstances [such as insolvency]." In re Estate of Trigg, 368 S.W.3d 483, 502 (Tenn. 2012).
- Relying on this principal, the Tennessee Supreme Court confirmed that the definition of "probate estate" for Medicaid estate recovery purposes includes real property solely owned by the deceased.
- In the case of Ms. Trigg, this meant that TennCare could recover from Ms. Trigg's homestead despite the devise of title immediately vesting in her beneficiary.

Homestead Example – Potential Solutions

- The initial response might be to put the real property in a revocable trust, to bring it out of the "probate estate."
- However, in In re Estate of Stidham, 438 S.W.3d 535 (Tenn. Ct. App. 2012), the Tennessee Court of Appeals took the ruling in Trigg one step further, and held that since the assets titled to the trustee of a revocable trust can be reached by an estate's personal representative to pay debts of the estate, and since a TennCare claim is a debt of the estate; the assets in the revocable trust are subject to recoupment.
- "We believe…that any property that can be reached by the personal representative pursuant to Tennessee Code Annotated section 35–15–505 for the payment of the debts of an insolvent estate may be reached by the probate court for the purpose of reimbursing the Bureau." Id. at 543.

Homestead Example – Potential Solutions

- Another option would be to gift the property outright (60 months before qualifying, so as to avoid the transfer penalty) to a child, sibling, etc.
- However, there are several potential disadvantages with this choice as well.
- Because the individual no longer owns the property, the individual experiences a loss of control, and the property is exposed to the transferee's liabilities (divorce, lawsuits, debts and taxes, uncertainties about premature death, etc.).
- Additionally, the transferee will lose the advantage of a step-up in tax basis on the death of the transferor.
- If the transferee sells the property, the sale will be subject to capital gains tax based on the transferor's tax basis, and the personal residence exclusion of $250,000 will likely be lost.

Homestead Example – Irrevocable Trust

- Transferring the home to an irrevocable grantor trust could solve the problems outlined above.
- Transferring the home to a properly designed irrevocable trust would allow the remainder beneficiaries to get a step-up in basis for the home on the grantor's death;
- the home would remain protected from the beneficiaries' liabilities until actually distributed;
- if the home is sold while the grantor is alive the personal residence exclusion on capital gains would not be lost;
- and the home would fall out of the "probate estate" and escape estate recovery.
- Of course, the transfer must take place at least 60 months before qualifying for benefits, so as to avoid the transfer penalty.

Features of Irrevocable Trust

- The grantor cannot be a beneficiary of the trust. The trustee cannot have even the smallest discretion to distribute any portion of the trust corpus to the grantor. "If there is a peppercorn of discretion, then whatever is the most the beneficiary might under any state of affair receive in the full exercise of that discretion is the amount that is counted as available for Medicaid eligibility." Cohen v. Comm'r of Div. of Med. Assistance, 668 N.E.2d 769, 777 (Mass. 1996).
- Income-only distributions should be ok (the income will be deemed an available resource, but the corpus of the trust will not).
- The trust can avoid gift tax and all assets can receive a step-up in basis at the grantor's death by the grantor retaining a limited power of appointment to name others as remainder beneficiaries. Code § 2036.

Features of Irrevocable Trust, Cont.

- Setting up the trust as a grantor trust will cause any capital gains on the sale of the property to be taxed to the grantor, with the personal residence exclusion preserved. A number of different provisions may be included to cause the trust to be a grantor trust, including the power of the grantor to borrow the trust corpus or the power of a nonadverse third party to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate consideration. See Code §§ 671-679.
- If the trust is also being used to qualify for VA benefits (see below), it may be wise to bifurcate the trust so that the grantor trust only holds the personal residence, and the main trust (not a grantor trust) avoids the income reporting requirements of a grantor trust which can cause problems with the VA.

VA Benefits – Aid and Attendance

- The Aid and Attendance pension is a "special monthly pension" intended to subsidize a wartime veteran or the surviving spouse of a wartime veteran because of the need for long-term care.
- To receive Veteran's Aid and Attendance benefits, the applicant must show:
  1) 90 days military active duty, one of which was during war time.
  2) Not dishonorably discharged.
  3) Disabled as defined by statute. 38 C.F.R. Sec. 4.17.
  4) Limited income and assets. 38 C.F.R. § 3.271-3.274.
- The maximum monthly benefit is currently $1,788 for a veteran with no dependents and $1,149 for the spouse of a veteran with no dependents.
- The VA currently has no look back period, so a transfer of assets to an irrevocable trust would immediately qualify the applicant for benefits. (Note, however, that the VA has proposed rules to introduce a three-year lookback for transfers of assets).

VA Benefits – Bifurcating Trusts

- The Department of Veterans Affairs compares income reported to the VA by pension recipients with IRS and SSA income records. This is commonly referred to as an Income Verification Match (or IVM).
- The income of a grantor trust which is reported on the grantor's personal income tax return and not reported to the VA can be very problematic. Because of IVM, the income will be assumed by the VA to be the veteran's and may terminate or compromise benefits.
- Thus, to the extent possible, it is probably safest when using trusts in the VA planning context to structure the trust as a non-grantor trust to avoid the attribution of trust income to the veteran establishing the trust.
- However, in order to preserve the personal residence exclusion from gain on sale, the claimant's personal residence should be held in a grantor trust.
- The solution could be to bifurcate the trust, with the personal residence in a grantor trust and the remaining assets in a non-grantor trust. If the house is ever sold, the proceeds from the sale should no longer be held in a grantor trust.

Thank You

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A Little About Your Presenter

MICHAEL R. CROWDER practices in the areas of estate planning and probate, elder law, and represents businesses and non-profits. Michael helps individuals in planning their estate, drafting wills, and setting up trusts, as well as in the administration of estates in probate court. He also helps individuals qualify for Medicaid, including representing clients in TennCare administrative hearings. He assists small businesses and non-profits such as churches and religious organizations on issues ranging from formation and governance, taxes, fundraising, employment issues, property rights, and litigation, including constitutional issues.

Michael graduated from the University of Tennessee, College of Law with a Concentration in Business Transactions from UT's Clayton Center for Entrepreneurial Law. While in law school Michael served on Transactions: The Tennessee Journal of Business Law and was vice-president of the Federalist Society. In his third year, Michael was a member of the College of Law's national finalist LawMeets Transactional Team. Prior to attending law school, Michael earned a Bachelor of Arts from Princeton University, where he majored in Religion and also played offensive line on the football team.