USING TRUSTS FOR TRADITIONAL AND ADVANCED ESTATE PLANNING AND FOR MEDICAID AND VETERANS BENEFITS

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TABLE OF CONTENTS

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Evan Farr is the creator of the **Living Trust Plus® Asset Protection System** used by dozens of Estate Planing and Elder Law Attorneys around the country, and is widely recognized as one of the foremost experts in the Country in the field of Medicaid Asset Protection and related Trusts. Evan is both a Certified Elder Law Attorney through the National Elder Law Foundation and a Member of NAELA's Council of Advanced Practitioners. Evan has been quoted or cited as an expert by numerous sources, including the *Washington Post*, *Newsweek Magazine*, *Northern Virginia Magazine, Trusts & Estates Magazine, The American Institute of Certified Public Accountants*, and the American Bar Association, and has been featured as a guest speaker on numerous radio shows, including WTOP and Washington Post Radio.

Evan has been named by SuperLawyers.com as one of the top 5% of Elder Law and Estate Planning attorneys in Virginia every year since 2007, and in the Washington, DC Metro Area every year since 2008. In 2011, Evan was named by Washingtonian Magazine as one of the top attorneys in the DC Metropolitan area and by Newsweek Magazine as one of the top attorneys in the country.

AV-Rated by Martindale-Hubbell, Evan is a nationally renowned Best-Selling author and frequent educator of attorneys across the U.S. As an expert to the experts, Evan has educated tens of thousands of attorneys across the country through speaking and writing for organizations such as his own Elder Law Institute for Training and Education, the National Academy of Elder Law Attorneys, the American Law Institute and American Bar Association, the National Constitution Center, the National Business Institute, myLaw CLE, the Virginia Academy of Elder Law Attorneys, the Virginia Bar Association, Virginia Continuing Legal Education, and the District of Columbia Bar Association. His publications include 3 Best-Selling books in the field of Elder Law: the ***Nursing Home Survival Guide***, which provides valuable information and guidance to families dealing with the possibility of nursing home care and struggling to make the best decisions for themselves or their loves ones; ***Protect & Defend***, which Evan authored along with a host of other top attorneys across the country; and ***How to Protect Your Assets From Probate PLUS Lawsuits PLUS Nursing Home Expenses with the Living Trust Plus®***. In addition, Evan has authored scores of articles that have appeared in the popular press, and dozens of scholarly publications for the legal profession, including two legal treatises published by American Law Institute in connection with the American Bar Associations: ***Planning and Defending Asset Protection Trusts*** and ***Trusts for Senior Citizens***.

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SECTION 1. REVOCABLE TRUSTS FOR ESTATE PLANNING

1.1. Benefits of a Revocable Living Trust

1.1.1. A Will Causes Probate.

1.1.1.1. The Revocable Living Trust (RLT) is a simple and proven alternative to a Will that avoids probate and lets your clients keep control of their assets while alive and distributes their assets according to their wishes upon death.

1.1.2. What is Probate?

1.1.2.1. There is lifetime probate, which occurs when someone becomes incapacitated without a Power of Attorney and requires the appointment of a Guardian and Conservator, and there is post-mortem (i.e., after death) probate. In this brochure, we will be talking about post-mortem probate, a court-supervised process by which the court sees that your debts are paid and your assets are distributed according to your Will. If you die without a valid Will, your assets are distributed according to state law, and go through the exact same probate process that occurs when you have a Will.

1.1.3. Why is Probate Such a Nightmare?

1.1.3.1. **The Expense.** Legal fees, executor fees and many other costs (typically totaling 5% to 8% of the value of the Estate) must be paid before your assets can be fully distributed to your heirs. If you own real estate in other states, your family will have to go through the nightmare of multi-state probate since real estate must be probated where it's located. These costs can vary widely; it would be a good idea to find out what they are now.

1.1.3.2. **The Time Commitment.** Probate usually takes at least two years, but often longer. During part of this time, assets are usually frozen so an accurate inventory can be taken. Nothing can be distributed or sold without court and/or executor approval.

1.1.3.3. **Annual Accountings.** Accountings must be filed with the Court every year that an estate remains open. The average accounting takes 40-60 hours to prepare, and almost never balances, requiring the Executor to often spend another 40-60 hours tracking down bank errors or accounting errors.

1.1.3.4. **Lack of Privacy.** Probate is a public process, so anyone can see what you owned, whom you owed, who will receive your assets and when they will receive them. The process "invites" disgruntled heirs to contest your Will and can expose your family to unscrupulous con artists and identity thieves.

1.1.3.5. **Lack of Control.** The court process determines how much it will cost, how long it will take, and what information is made public.

1.1.4. What is a Revocable Living Trust?

1.1.4.1. An RLT is an entity, created by a legal document that, like a Will, contains your instructions for what you want to happen to your assets when you die. Assets in your RLT avoid probate at death because a Trust does not die. An RLT does not protect your assets from lawsuits or nursing home expenses.

1.1.5. How Does a Living Trust Avoid Probate?

1.1.5.1. When you establish an RLT, you re-title your assets from your name to the name of your Trust, which you control as Trustee. For example, we will prepare a Deed transferring the house from "John and Mary Doe" to "John and Mary Doe, Trustees under the John and Mary Doe Trust." The goal is for you to legally no longer own anything. If, upon your death, everything belongs to your Trust, there is nothing to go through probate.

1.1.6. Do I Lose Control of the Assets in My Revocable Living Trust?

1.1.6.1. No. You keep full control. As Trustee of your RLT, you can do anything you could do before—buy and sell assets, change investments, and even revoke your Trust.

1.1.7. Do I Have to File a Separate Tax Return for My RLT?

1.1.7.1. No. You file the same tax 1040 tax return that you always have. An RLT requires no extra tax filings.

1.1.8. Is it Hard to Transfer Assets into Trust?

1.1.8.1. No. The process is called "Trust funding." The attorney typically takes care of re-titling all real estate. If you have a financial advisor and/or insurance agent, they can help with Trust funding. Alternatively, simply call each of your financial institutions and tell them you're creating a Trust, and ask each one to send you the proper form to fill out (every financial institution has its own form). Be sure to not delay funding your RLT, as your RLT can only protect assets that have been re-titled into it. Beneficiary designations (for example, with insurance policies and IRAs) should also typically be changed to your Trust so the court can't control them if a beneficiary is incapacitated or no longer living when you die.

1.1.9. Is Funding the Trust Time Consuming?

1.1.9.1. It will take some extra effort and time to fund your Trust as opposed to just doing a Will, but you can either take this extra time now, or you can pay the courts and attorneys to guide your Estate through the nightmare of probate for you upon your death. If you want to make thing easier for your family upon your death, a Trust is absolutely the way to go. A Will is easier for you now, but creates a nightmare for your family upon your death.

1.1.10. Who Controls the Trust Assets While I'm Alive?

1.1.10.1. The Trustee manages all of the assets inside the Trust. If you're not married, you will typically be the sole Trustee of your Trust, and have full use of and control over all Trust assets. If you're married and don't have children from a prior relationship, then typically you will have a joint Trust and you and your spouse will be co-Trustees, meaning both of you have full use of and control over all Trust assets and, if one of you becomes incapacitated or dies, the other spouse simply continues to act as the sole Trustee of the Trust. If you are married, but one or both of you have children from a prior relationship, then you will often have two separate Trusts, with each of you controlling your own Trust. If something happens to the initial Trustee(s) of a Trust, then a successor Trustee that have you have selected will step in and take over managing the Trust assets.

1.1.11. Who Controls the Trust Assets After My Death?

1.1.11.1. Upon your death, or if you become incapacitated, the successor Trustee or co-Trustees that you named in the Trust document take over managing the assets in the Trust. When you die, your successor Trustee pays your debts, files your tax returns and distributes your assets. All of this can be done quickly and privately, according to the instructions spelled out in your Trust, without any court involvement.

1.1.12. Who Can Be Successor Trustees?

1.1.12.1. Successor Trustees are typically individuals, such as your adult children, other relatives, or Trusted friends. Alternatively, you can name a professional Trustee such as a Trust Company or law firm. If you choose an individual, you should also name additional successors in case your first choice is unable or unwilling to act as your Trustee.

1.1.13. Does My Trust End When I Die?

1.1.13.1. Unlike a Will, a Trust does not die when you die. Assets can stay in your Trust as long as you want them to, and be managed by the successor Trustee(s) you selected, until your beneficiaries reach the age(s) you want them to inherit. Your Trust can even continue for a loved one's lifetime if you have a beneficiary with special needs, or to protect the assets from a beneficiary's future possible creditors, such as a lawsuit, a divorce, or catastrophic medical or nursing home expenses.

1.1.14. Can't a Trust Inside a Will Do the Same Thing?

1.1.14.1. Yes, but with a huge downside. A Will can contain wording to create what's called a "testamentary Trust" after your death. But because the testamentary Trust is part of your Will, a testamentary Trust is an extension of probate, and in Virginia and most other states, the Trustee of a testamentary Trust has to file annual accountings with the court every year that the testamentary Trust remains in existence. So, for example, the Trustee of a testamentary Trust for a minor will have to file accountings with the court every year until the child reaches age 18 or some other age specified in the Will. Even worse, if you have a special needs child, the Trustee of your child's testamentary Special Needs Trust will have to file annual accountings for the remainder of your child's lifetime. One of the main reasons for a Living Trust is to avoid the filing of these horrendous annual accountings.

1.1.15. If I Have a Revocable Living Trust, Do I Still Need a Will?

1.1.15.1. Yes, you need a "pour-over" will that acts as a safety net if you forget to re-title an asset into Trust. When you die, the Will "catches" the forgotten asset and pours it into your Trust. The asset may have to go through probate first, but it can then be distributed as part of your overall Living Trust plan. If you have minor children, you also need a Will to appoint Guardians.

1.1.16. Are Revocable Living Trusts New?

1.1.16.1. No, Trusts been used successfully for hundreds of years, longer than Wills.

1.1.17. Who Should Have a Revocable Living Trust?

1.1.17.1. If you own titled assets and want your loved ones to avoid the nightmare of probate upon your death, you should have an RLT to avoid probate. However, if you're over 65 or worried about the future expenses of nursing home care or other long-term care, you should consider a Living Trust Plus® Asset Protection Trust, designed to protect your assets from the nightmare and expenses of probate PLUS lawsuits PLUS nursing home expenses and other long-term care expenses.

SECTION 2. IRREVOCABLE TRUSTS FOR MEDICAID ASSET PROTECTION PLANNING

2.1. Living Trust Plus® Asset Protection Trusts.

2.1.1. General Considerations.

2.1.1.1. There is little reason for middle class Americans desiring to create an asset protection trust to go outside of their home state. Residents of most states may create a Living Trust Plus® Asset Protection Trust to protect their assets. With a standard Living Trust Plus®, the settlor retains the right to receive the trust income, but does not retain the right to access the corpus/principal[1] of the trust. Because of the way this trust functions, it is sometimes referred to as an "income-only trust." However, most so-called "income-only trusts," as will be seen by the cases examined later herein, are drafted improperly, whereas the Living Trust Plus® has been perfected by your author and is used successfully by dozens of attorneys across the country. Principal of the Living Trust Plus® can be retained in the trust or distributed to beneficiaries other than the settlor or the settlor's spouse. After the settlor's death, a Living Trust Plus® may terminate or may continue with income payable to the settlor's spouse and corpus distributed to or held in further trust for the benefit of the remainder beneficiaries, typically the settlor's children.

2.1.1.2. For middle class Americans, the Living Trust Plus® is the preferable form of asset protection trust because, for purposes of Medicaid eligibility, the Living Trust Plus® is the **only** type of self-settled asset protection trust that allows a settlor to retain an interest in the trust while also protecting the assets from being counted by state Medicaid agencies. For Medicaid eligibility purposes, if the settlor has any access to the corpus of a trust,[2] then the entire balance of the trust is a countable resource.[3]

2.1.1.3. The settlor of the Living Trust Plus® can serve as the Trustee,[4] which is an important consideration for many persons wanting to establish an asset protection trust.

2.1.2. Practical Considerations.

2.1.2.1. Middle class Americans seeking asset protection can not afford to ignore the potentially devastating costs of nursing home care and other long-term care. On the contrary, nursing homes are the most likely and one of the most expensive creditors that the average American is likely to face in his or her lifetime. Consider the following statistics:

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[1] The term corpus and principal are used interchangeably herein, as the principal of a trust is the same as the corpus of a trust.

[2] As is the case with so-called "Offshore Asset Protection Trusts" (discussed *infra*, section?) and "Domestic Asset Protection Trusts" (discussed *infra*, section 2.12).

[3] *See infra*, section 2.2.3.

[4] *See supra* section 2.4.1, 2.4.3, 2.10.1, 2.10.2.

2.1.2.1.1. About 70% of Americans who live to age 65 will need long-term care at some time in their lives,[5] over 40 percent in a nursing home.[6]

2.1.2.1.2. As of 2018, the cost of a private room in a nursing home in the Washington, DC Metro area was over $140,000 per year, and the average cost of a semi-private room was over $126,000 per year. The national average cost of a private room in a nursing home was over $100,000 per year, and the national average cost of a semi-private room was almost $90,00 per year.[7]

2.1.2.1.3. On average, someone age 65 today will need some long-term care services for three years. Women need care for longer (on average 3.7 years) than do men (on average 2.2 years). While about one-third of today's 65-year-olds may never need long-term care services, 20 percent of them will need care for more than five years.[8]

2.1.2.1.4. Also, long-term care is not just needed by the elderly. A study by Unum, released in November, 2008, found that 46 percent of its group long-term care claimants were under the age of 65 at the time of disability.[9]

2.1.2.2. Contrast the above long-term care statistics with statistics for automobile accident claims and homeowner's insurance claims:

2.1.2.2.1. Between 2005 and 2007, an average of only 7.2% of people per year filed an automobile insurance claim.[10]

2.1.2.2.2. Between 2002 and 2006, an average of only 6.15% of people per year filed a claim on their homeowner's insurance.[11]

2.2. Using the Living Trust Plus® Income-Only Trust for Medicaid Asset Protection.

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[5] *Americans Fail to Act on Long Term Care Protection*, American Society on Aging, May 2003. National Clearinghouse for Long-Term Care Information, http://www.longtermcare.gov at http://www.longtermcare.gov/LTC/Main_Site/Understanding_Long_Term_Care/Basics/Basics.aspx#needs.

[6] National Clearinghouse for Long-Term Care Information, http://www.longtermcare.gov at http://www.longtermcare.gov/LTC/Main_Site/Understanding_Long_Term_Care/Basics/Basics.aspx#needs.

[7] Genworth Cost of Care Survey 2018, https://www.genworth.com/aging-and-you/finances/cost-of-care.html

[8] National Clearinghouse for Long-Term Care Information, http://www.longtermcare.gov at http://www.longtermcare.gov/LTC/Main_Site/Understanding_Long_Term_Care/Basics/Basics.aspx#needs.

[9] Insurance Information Institute, http://www.iii.org/media/facts/statsbyissue/longtermcare.

[10] Insurance Institute for Highway Safety, http://www.iii.org/media/facts/statsbyissue/auto, based on data from the Highway Loss Data Institute.

[11] Insurance Institute for Highway Safety, http://www.iii.org/media/facts/statsbyissue/homeowners, based on data from the Insurance Services Office.

2.2.1. Basic Overview of Medicaid Asset Protection Planning.

2.2.1.1. **Introduction.** A detailed understanding of Medicaid rules and Medicaid Asset Protection strategies is beyond the scope of this book.[12] However, a very basic understanding of the Medicaid lookback period and transfer penalty rules is essential to an understanding of the use of and importance of the Living Trust Plus® Income-Only Trust.

2.2.1.2. **Lookback Period.** For Medicaid eligibility purposes, since February 8, 2006, there has been a 5-year lookback period for uncompensated transfers.[13] This means that on an application for Medicaid benefits, there is a question which asks if the applicant or the applicant's spouse has made any uncompensated transfers made to an individual or to a trust within the previous 5 years. All such transfers must be disclosed to Medicaid, and failure to do so constitutes Medicaid Fraud, which is a criminal offense.

2.2.1.3. **Transfer Penalty.** Any uncompensated transfer of assets made within the 5-year lookback period results in a penalty period, which is a period of ineligibility for Medicaid long-term care. The period of ineligibility does not begin when the transfer is made, but rather when the person enters the nursing facility, applies for Medicaid, is "otherwise eligible" for Medicaid, meaning the person has countable assets of less than the minimum resource allowance ($2,000 in most states) and is medically in need of nursing home care. The penalty period is calculated by dividing the amount of the transfer by an amount called the "penalty divisor," which differs from state to state. The penalty period resulting from an uncompensated transfer can be longer than 5 years.

2.2.1.4. **Example 1.** Joe transfers $500,000 to a Living Trust Plus® in January of 2009, and then enters a nursing home and applies for Medicaid in December of 2014. The penalty divisor for Joe's state is $5,000. Joe is eligible for Medicaid but for the uncompensated transfer. By applying for Medicaid before the expiration of the 5-year lookback period, Joe must report the $500,000 uncompensated transfer, which results in a 100-month penalty period, so Joe is not eligible for Medicaid long-term care until April, 2023.

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[12] For a comprehensive treatise on Medicaid Asset Protection, including a small section on the use of income-only trusts, see Begley, Jr. & Hook, *Representing the Elderly or Disabled Client: Forms and Checklists with Commentary* ¶ 7.02 (WG&L 2007).

[13] Prior to the enactment of the federal Deficit Reduction Act ("DRA"), Pub. L. No. 109-171 (2/8/2006), the lookback period was three years for outright transfers and 5 years for transfers to trust. This disparity in the treatment of transfers made pre-DRA transfers into irrevocable trusts much less attractive than they are now. For a good explanation of the background and history of income-only trusts, *see* Shirley B. Whitenack, Gary Mazart, and Regina M. Spielberg, *The Revival of the Income-Only Trust in Medicaid Planning*, Estate Planning J. (WG&L January 2009).

2.2.1.5. **Example 2.** Same facts except Joe waits to apply for Medicaid until March of 2015. By applying for Medicaid after the expiration of the 5-year lookback period, Joe does not have to report the $500,000 uncompensated transfer, meaning there is no penalty period and Joe is eligible for Medicaid in the month of application.

2.2.2. Purpose of Using the Living Trust Plus® Income-Only Trust.

2.2.2.1. **Asset Protection**. The Living Trust Plus® Income-Only Trust is a means by which clients can transfer assets they wish to protect to a trust rather than directly to their children. Clients rightfully view transfers to trusts as protection, whereas transfers to adult children are typically viewed as gifts. Trusts provide clients with a sense of dignity and security.[14] Such transfers, whether to a Living Trust Plus® Income-Only Trust or directly to a child, are subject to the Medicaid five-year lookback period.[15]

2.2.2.2. **Independence**. By transferring assets to a Living Trust Plus® Income-Only Trust, income is paid directly to the trust settlor rather than to her children, allowing the settlor to maintain greater financial independence. When real estate is transferred to a Living Trust Plus®, the trust should enter into an occupancy agreement with the settlor so that the settlor retains the right to live in the real estate or receive the rental income from any rental property.

2.2.2.3. **Risk-Avoidance**. If a parent transfers assets directly to his children, certain risks must be anticipated: creditors claims against a child; divorce of a child; bad habits of a child; need for financial aid; loss of step-up in basis.

2.2.2.3.1. A transfer to a Living Trust Plus® Income-Only Trust avoids all of these risks.[16]

2.2.3. Statutory Authorization.

2.2.3.1. The Living Trust Plus® Income-Only Trust is permitted under the federal Medicaid law OBRA '93,[17] which states:

> "In the case of an irrevocable trust . . . if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the

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14 Begley, Jr. & Hook, *Representing the Elderly or Disabled Client: Forms and Checklists with Commentary* ¶ 7.02 (WG&L 2007).

15 *See supra*, section 2.2.1.2.

16 *See infra,* section 2.6.7, 2.11.7, for an explanation of why a transfer to a Living Trust Plus® avoids the loss of step-up in basis.

17 42 U.S.C. § 1396p(d)(3)(B).

portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual."

2.2.3.2. Under 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, other than by will,[18] by any of the following: the individual, the individual's spouse, a person (including a court or administrative body) with legal authority to act on behalf of the individual or the individual's spouse, or a person (including a court or administrative body) acting at the direction or request of the individual or the individual's spouse.[19]

2.2.3.3. The Living Trust Plus® Income-Only Trust is also permitted under the CMS State Medicaid Manual, which states that:

> "In the case of an irrevocable trust, where there are any circumstances under which payment can be made to or for the benefit of the individual from all or a portion of the trust . . . [t]he portion of the corpus that could be paid to or for the benefit of the individual is treated as a resource available to the individual." [20]

2.2.3.4. However, neither OBRA '93 nor the CMS State Medicaid Manual fully explain how or why irrevocable income-only trusts work, because the language of OBRA '93 and the CMS State Medicaid Manual is ambiguous. What did Congress mean when it wrote in OBRA '93 that "[t]he portion of the corpus that could be paid to or for the benefit of the individual is treated as a resource available to the individual." Does this mean that because the corpus is what generates the income, that the entire corpus is countable because the income can be distributed to the Trust Settlor? No, that is not what Congress or CMS intended, and this was fully and clearly explained via two letters -- the Streimer letter and the Richardson letter -- written by the then-heads of HCFA, the predecessor agency to CMS. The Streimer and Richardson letters, taken together, contain the full interpretation of OBRA '93 and, together with OBRA '93, still stand as the federal law governing irrevocable income-only trusts.

[18] The creation and funding of a testamentary trust is not a disqualifying transfer of assets. *See Skindzier v. Comm'r of Soc. Servs.*, 784 A2d 323 (Conn. 2001) .

[19] 42 USCA § 1396p(d)(2).

[20] CMS State Medicaid Manual, Section 3259.6.B.

2.2.3.5. Under the Richardson letter, dated December 23, 1993[21]:

• "If there are any circumstances under which either income or trust corpus could be paid to the individual, then actual payments to the individual of either income or corpus are deemed 'income' for Medicaid eligibility purposes.

• "If trust corpus could be paid to an individual but is not, such asset is deemed an available resource for Medicaid eligibility purposes.

• "If no portion of the trust corpus may be distributed to an individual, *i.e.*, an 'income only trust,' then no portion of the trust is deemed a resource of the individual for Medicaid eligibility purposes.

• "If some portion of the irrevocable trust corpus could be paid to an individual, and assets are transferred from the trust to someone other than the individual, then the individual is subject to the Medicaid three-year lookback."

"This left open the issue of whether a lookback period applied for transfers to or from an income-only trust. Even the Health Care Finance Administration (HCFA) was not sure which interpretation was correct.[22] HCFA finally clarified the rules in a letter dated February 25, 1998." [23]

2.2.3.5.1. The Streimer letter referenced above,[24] clarified the rules by stating as follows:

2.2.3.5.1.1. **For Transfers To an Income-Only Trust:**

"Transfers to an irrevocable trust with retained income only interests are considered available only to the extent of the income earned. Otherwise, the assets are considered to have been transferred with a 5-year lookback period."

2.2.3.5.1.2. **For Transfers From an Income-Only Trust:**

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[21] *Citing* Letter from Sally K. Richardson, Director of Medicaid Bureau, Health Care Financing Administration, Dep't of Health and Human Services, to Ellice Fatoullah, Esq., Elder Law Report, Vol. V, No. 7, p. 2, Dec. 23, 1993.

[22] *Citing* Q & A 83, Summary of Verbal Q & A's from HCFA Central to the Regions (Nov. 4, 1993).

[23] *Citing* Letter from Robert A. Streimer, Director, Disabled and Elderly Health Programs Group, Center for Medicaid and State Operation, Health Care Finance Admin., Dep't of Health and Human Services, to Dana E. Rozansky, Elder Law Report, Vol. IX, No. 9, p. 9, Apr. 1998.

[24] Available at http://www.sharinglaw.net/elder/Streimer.pdf.

"[W]here assets in a trust can not be made available to the beneficiary, transfer of those assets to or for the benefit of someone other than the beneficiary does not incur a separate transfer penalty. Any penalty would have been assessed when the funds were placed in the trust."

2.2.4. Administrative Actions Presumed Correct.

2.2.4.1. The Richardson letter and the Streimer letter referenced above are administrative actions and therefore presumed to be accurate statements of the law because they constitute administrative action taken by a Federal administrative agency. It is presumed that all administrative actions are made in accordance with statutory provisions.

2.2.4.2. The management of the Medicaid laws is committed to the executive branch of government through duly designated officials charged with administering the Medicaid program – in this case HCFA (now CMS). Judgments of administrative officials are entitled to be regarded by the courts as presumptively correct . . .").[25] Moreover, an agency's expertise and experience only strengthens the presumption taken in its favor.[26]

2.2.5. Corpus Distribution Provision.

2.2.5.1. There can be absolutely no access to corpus by either the settlor or the settlor's spouse. If either spouse has direct access to corpus/principal, the trust is not an income-only trust, and the assets in the trust would be available to creditors and deemed "countable" for Medicaid eligibility purposes.[27]

2.2.5.2. The Living Trust Plus® Income-Only Trust is designed to permit the trustee, or a third party, to make distributions to beneficiaries. Through this mechanism, the trustee can stop income payments to a settlor who will be requiring Medicaid and

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[25] *See, e.g., Bush v. Gore*, 531 U.S. 98, 116 (2000), stating that "[t]he election process . . . is committed to the executive branch of government through duly designated officials all charged with specific duties . . . . [The] judgments [of these officials] are entitled to be regarded by the courts as presumptively correct . . .". *See also Archdiocese of Portland V. County of Washington*, 458 P.2d 682, 684-685 (1969), stating that the actions of an administrative agency "will be presumed valid, reasonable, correct, taken in knowledge of material facts, justified by the facts, made upon full hearing or after giving all interested parties a reasonable opportunity to be heard and upon appropriate evidence duly considered and properly applied." *See also Fairfax Nursing Ctr., Inc. v. Califano*, 590 F.2d 1297, 1301 (4th Cir. 1979), discussing the "judicial presumption of legality of administrative action," *quoting Springdale Convalescent Center v. Mathews*, 545 F.2d 943, 955 (5th Cir. 1977); *Campaign Clean Water, Inc. v. Train*, 489 F.2d 492, 501 (4th Cir. 1973), vacated and remanded on other grounds, 420 U.S. 136, 95 S. Ct. 847, 43 L. Ed. 2d 82 (1975).

[26] See, e.g., *Standard Oil Co. v. Department of Energy*, 596 F.2d 1029 (Temp. Emer. Ct. App. 1978).

[27] Begley, Jr. & Hook, *supra* § 7.02[7][b].

can avoid estate recovery in those states that use a broad definition of "estate."[28] Through this mechanism, the beneficiaries could also, if they choose, make distributions of what was trust corpus/principal back to the settlor or for the benefit of the settlor.

2.2.5.2.1. The disadvantage of distributing the assets from the Living Trust Plus® Income-Only Trust is that the opportunity for a "step- up" in basis will be lost.[29]

2.2.5.2.2. It is essential, of course, that there be no collusion between the settlor and the trust beneficiaries whereby the trust beneficiaries agree in advance to make principal distributions back to the settlor or for the benefit of the settlor.

2.2.5.3. Care must be taken in considering whether to authorize a trustee who is not the settlor to make distributions of trust principal to himself. Authorization of such distributions would be considered a general power of appointment held by the trustee, and if the trustee predeceases the settlor, the value of the trust assets could be included in the estate of the trustee for estate tax purposes.[30] This can be avoided by requiring a trust protector or independent trustee to acquiesce in any transfers to the trustee.

2.2.6. Cases Illustrating Prohibition of Retained Interest in Corpus.

2.2.6.1. A trust in which the settlor or the settlor's spouse retains an interest in the corpus/principal is not a income-only trust. The following cases illustrate this point:[31]

2.2.6.1.1. In both *United States v. Ritter United States v. Ritter*, 558 F.2d 1165, 1167 (4th Cir. 1977), and *Petty v. Moores Brook Sanitarium*, 110 Va. 815 (1910), the trust settlor retained the right to have the trust corpus returned to the settlor in the discretion of the Trustee. This retained power to return of the corpus was clearly a significant factor for both courts in concluding that the trust assets were not protected from the creditor of the settlor.

2.2.6.1.2. *In Re Robbins*, 826 F.2d 293 (4th Cir. 1987) is a case arising in Maryland that was decided on the basis of the settlor's retained interest in the corpus of the

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[28] *See supra*, section 2.2.9.

[29] Begley, Jr. & Hook, *supra* § 7.02[7][c].

[30] Begley, Jr. & Hook, *supra* § 7.02[7][c].

[31] Many of the cases cited in this section have been erroneously categorized by some commentators as income-only trusts, and therefore relied on to attempt to demonstrate that income-only trusts are not effective asset protection entities; however, as explained herein, none of the cases cited in this section were properly drafted as income-only trusts, as they all contained provisions allowing distribution of principal to the trust settlors.

trust. The Fourth Circuit held that under the terms of the trust, the trustee was authorized to apply the entire corpus for the support and maintenance of the settlors, and thus the entire corpus was subject to the claim of their creditors. *Id.* at 294.

2.2.6.1.3. In the Pennsylvania case of *In re Nolan*, 218 Pa. 135, 67 A. 52 (1907), the settlor retained the power to appoint the remainder and the trustee had the power to reconvey the property to the settlor. The Court held that no creditor protection was available.

2.2.6.1.4. In *Gayan v. Illinois Dept. of Human Services,* Ill. App. Ct., No. 3-02-0545 (Aug. 29, 2003), an irrevocable trust that allowed the trustee to distribute principal to pay for costs of custodial care not covered by Medicaid was found to be an available asset, the settlor's intent notwithstanding.

2.2.6.1.5. In *Balanda v. Ohio Dept of Job and Family Services,* 2008-Ohio-1946 (April 24, 2008), an Ohio appeals court ruled that assets held in an irrevocable trust were available to a Medicaid applicant because the trustee had the discretion to make payments of trust principal for the benefit of the applicant and the applicant's spouse.

2.2.6.1.6. In *Wisynski v. Wis. D.O.H. & Family Serv.,* Wis. App., Dist. 3, No. 2008AP1280 (Nov. 4, 2008), the irrevocable trust inovolved does not appear to have been written as an income-only trust, but the opinion is not clear on that issue, as it does not give any information about the trust other than to say that the Medicaid applicant named himself as a "beneficiary." The opinion does not explain whether the applicant named himself as a beneficiary of income, principal, or both. The use of the term "beneficiary" without further limiting the language would imply that the applicant was a beneficiary of both income and principal, properly resulting in the trust principal being found to be available.

2.2.6.1.7. *Clifford and Ruth Oyloe v. North Dakota Department of Human Services*, 2008 ND 67; 747 N.W.2d 106; N.D. LEXIS 66 (April 17, 2008). This case, from the Supreme Court of North Dakota, involved a claim by the State Medicaid Agency ("Agency") that the assets of the applicant's irrevocable trust were countable for purposes of Medicaid.

2.2.6.1.7.1. The Agency challenged the trust the grounds of a drafting error involving the proceeds that were paid into the trust after the sale of real estate. The trust gave the trustee discretion to sell the Oyloes' home and distribute the proceeds if the Oyloes no longer resided there. Paragraph 2(b) of the trust provided:

> "During the joint lifetime of the Grantors, if there ever comes a time when neither of the Grantors is living in the personal residence of the Grantors transferred into trust and it is unlikely to ever be occupied by them again, the Trustee has the option to sell said personal residence and immediately distribute the proceeds from the sale in accordance with the terms of paragraph

1.(d) of this Agreement, subject only to the requirements of paragraph 4."

2.2.6.1.7.2. The crucial drafting error was that the trust agreement did not contain a paragraph 1.(d). Accordingly, the Court found the sales proceeds from the house could possibly be given back to the Grantor, meaning that the trust was actually not an income-only trust, but rather one that allowed principal distributions to the Grantor.

2.2.6.1.7.3. Importantly, the Agency did not take the position that the other trust assets were countable assets for Medicaid purposes.

2.2.6.1.8. *Boruch v. Nebraska Dept. Of Health & Human Servs.*, 11 Neb. App. 713, 659 N.W.2d 848 (2003). This case, from the Nebraska Court of Appeals, involved the appeal of a Medicaid applicant ("Lambert Boruch") of a determination by the State Medicaid Agency ("Agency") that the assets of Boruch's irrevocable trust were countable for purposes of Medicaid. According to the Court, "Lambert [Boruch] was the grantor and *beneficiary of the corpus* of the Trust, and his son, Ronald, was a co-successor trustee." The Court goes on to explain that "[t]he Trust was established as an irrevocable instrument and provided that the beneficiary, Lambert, was entitled to the use and possession of the real property, as well as the annual net income derived therefrom, for his lifetime." *Id.* at 714 (emphasis added). Clearly, this trust was not properly structured as an income-only trust, as the Court indicated that Boruch was the beneficiary of the corpus of the Trust, which is a feature that is absolutely prohibited in a properly-structured income-only trust such as the Living Trust Plus® Income-Only Trust.

2.2.6.1.9. Although there is a disturbing interpretation of the law in *Boruch* (stating that "if an individual establishes an irrevocable trust with his or her funds and is the beneficiary of or can benefit from the trust under any circumstances, the trust corpus is counted in the determination of Medicaid eligibility" *Id.* at 719), this interpretation of federal Medicaid law[32] is entirely aberrational and is not supported by the law. In any event, this aberrational finding can arguably be considered dicta in that the trust in question was clearly not properly structured as an income-only trust.

2.2.6.1.9.1. The Court also indicated that the Medicaid applicant in Boruch was the "sole beneficiary" of the trust (*Id.* at 720), presumably meaning that there were no remainder beneficiaries of the trust, and in fact the Court's opinion gives no indication of any remainder beneficiaries named in the trust. An important feature of a properly-drafted income-only trust is that the corpus of the trust is immediately vested in the remainder beneficiaries (who therefore have the right to enforce the terms of the trust), while only the income interest is retained by the settlor. Even if the trust in *Boruch* had been a properly-structured income-only trust with the settlor ostensibly retaining no interest in the corpus, without any remainder

[32] 42 USC § 1396p(d)(3)(B).

beneficiaries there is no one to enforce the terms of the trust, and the trust is therefore analogous to a revocable trust whose assets are completely available for the purposes of Medicaid. Although this rationale was not articulated by the Court in *Boruch,* it is possible that this might have had an affect on the Court's decision.

2.2.7. Income Distribution Provisions.

2.2.7.1. Although neither the settlor nor the settlor's spouse can receive distributions from corpus, they can receive distributions of trust income. In this writer's opinion, and as defined in the Living Trust Plus® Income-Only Trust, "income" means interest, ordinary dividends,[33] rental income, royalties, and any other taxable income that does not qualify for capital gains treatment. The reason for excluding capital gains from the definition of income is that historically capital gains have been considered to be part of corpus/principal, and trustees were required to distribute only income to the income beneficiaries, retaining the principal/corpus and all capital gains realized by the trust for the ultimate benefit of the trust's remainder beneficiaries.[34]

2.2.7.2. This view of what constitutes "income" for purposes of the Living Trust Plus® Income-Only Trust is this writer's opinion based upon an abundance of caution developed over many years of dealing with Medicaid officials. It is also based on the desire of most clients to protect as much of their assets as possible using the Living Trust Plus® Income-Only Trust, and defining capital gain as part of principal/corpus is consistent with this goal. Other commentators do not distinguish between different types of income in the context of an income-only trust, and some drafters of income-only trusts have historically treated distributions of capital gains as income distributions. Unfortunately, this is a very complex area made even more difficult by the fact that the definition of income for tax purposes is different from the definition of income for Medicaid purposes.

2.2.7.3. The IRS definition of income in the context of trusts states that the term "*income*, when not preceded by the words *taxable*, *distributable net*, *undistributed net*, or *gross*, means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law." It further explains that "items such as dividends, interest, and rents are generally allocated to income and proceeds from the sale or exchange of trust assets are generally allocated to principal."[35]

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[33] Perhaps also "qualified dividends," but *see* n.20 for a further discussion of allowable distributions of income..

[34] *See* Barbara A. Sloan, T. Randolph Harris, and George L. Cushing, *When Income Isn't 'Income'—The Impact of the New Proposed Regulations Under Section 643*, Journal of Taxation (WG&L June 2001).

[35] Treas. Reg. § 1.643(b)-1.

2.2.7.4. The relevant Federal Medicaid law, OBRA '93,[36] states that the term "income" has the meaning given such term in 42 U.S.C. § 1382a, which in turn states, in the context of trusts, that income includes: "any earnings of, and additions to, the corpus of a trust established by an individual . . . and, in the case of an irrevocable trust, with respect to which circumstances exist under which a payment from the earnings or additions could be made to or for the benefit of the individual."[37]

2.2.8. Adjustments Between Principal and Income.

2.2.8.1. The trustee must be affirmatively prohibited from exercising any powers to adjust between income and principal, regardless of whether such powers are granted by common law or statute or both.

2.2.8.1.1. The Trustee must not have the power adjust between income and principal.[38]

2.2.8.1.2. Likewise, the Trustee must not have the power to convert the trust to a total return unitrust.

2.2.8.2. The importance of the above rules is demonstrated by a 2009 Massachusetts case, *Doherty v. Director of the Office of Medicaid*, in which the Appeals Court of Massachusetts stated that "we take this opportunity to stress that we have no doubt that self-settled, irrevocable trusts may, if so structured, so insulate trust assets that those assets will be deemed unavailable to the settlor." However, the trust reviewed by the Court in *Doherty*, through ostensibly written as an income only trust, was utterly defective in that it allowed distributions of principal via adjustments between income and principal. Although the trust explicitly provided that the trustee may "make no distributions of principal from the Trust, to or on behalf of" the settlor, the trust also gave the trustee the power to "determine all questions as between income and principal and to credit or charge to income or principal or to apportion between them any receipt or gain."

2.2.9. Medicaid Estate Recovery.

2.2.9.1. Federal law requires states to institute programs to recover nursing home and long-term care Medicaid expenses paid after 10/1/93, from the estates of deceased

[36] 42 U.S.C. § 1396p(e)(2).

[37] 42 U.S.C. § 1382a(a)(2)(G).

[38] *Doherty v. Director of the Office of Medicaid*, 74 Mass. App. Ct. 439, 908 N.E.2d 390 (Mass. App., 2009).

Medicaid beneficiaries.[39] Whether estate recovery applies to assets held in an income-only trust depends, in part, on whether a state uses the narrow, "probate" definition of "estate" or a broad definition of "estate" that includes a living trust.[40]

2.2.9.2. At least 30 states use the narrow probate definition of estate in their Medicaid recovery program, while at least 14 states use an expanded definition of estate in their Medicaid recovery programs to include both probate and non-probate assets.[41]

2.2.9.3. In a situation involving an unmarried person, if the assets were transferred by the Medicaid recipient to a Living Trust Plus® Income-Only Trust for the benefit of the Medicaid recipient, the Medicaid recipient subsequently died, and the state had a narrow definition of "estate," the assets in the trust would not be subject to estate recovery. Given the same facts in a state with a broad definition of "estate," the assets in the trust may be subject to estate recovery. An argument could be made that the estate recovery statute applies only if there is a living trust in which the Medicaid recipient had a "legal interest" at the time of death. Because the beneficiary of a trust has an equitable interest rather than a legal interest, an argument can be made that the assets in the trust are not subject to estate recovery. A more conservative approach would be that the assets in the trust are subject to estate recovery in those states that use a broad definition of "estate."[42]

2.2.9.4. A Living Trust Plus® Income-Only Trust established for the benefit of the spouse of a Medicaid recipient, in which the Medicaid recipient has no legal interest at death, should not be subject to estate recovery on the Medicaid recipient's death.[43]

2.2.9.5. However, some states with expanded definitions of estate recovery will seek estate recovery against the estate of the spouse of the Medicaid recipient against assets in which the Medicaid recipient holds no legal interest at the time of his or her death.[44]

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[39] 42 U.S.C. §1396p(b). Pursuant to 42 U.S.C. §1396p(b)(2)(A), estate recovery may be made only after the death of the Medicaid recipient's spouse and may not be made if there is a surviving child who is a minor or who is disabled or blind.

[40] Begley, Jr. & Hook, *supra* at § 7.02[4].

[41] *See* Oppenheim and Moschella, *National Perspective on Expanded Estate Recovery: Case Law Analysis, Emerging Legislative Trends and Responsive Strategies for the Elder Law Attorney*, 1 NAELA J. 7 (Spring 2005).

[42] Begley, Jr. & Hook, *supra* at § 7.02[4].

[43] *See* Shirley B. Whitenack, Gary Mazart, and Regina M. Spielberg, *The Revival of the Income-Only Trust in Medicaid Planning*, Estate Planning J. (WG&L January 2009).

[44] *See* Whitenack, Mazart, and Spielberg, *The Revival of the Income-Only Trust in Medicaid Planning*, *supra*., for a review of cases allowing expanded estate recovery from a trust.

2.2.9.6. As discussed earlier, the Living Trust Plus® Income-Only Trust is be designed to permit the trustee, or a third party, to make distributions to beneficiaries. Through this mechanism, the trustee can stop income payments to a settlor who will be requiring Medicaid and can avoid estate recovery in those states that use a broad definition of "estate." Such distribution of assets and termination of income payments might be considered an uncompensated transfer (of the right to receive future income payments) if the Medicaid applicant participates in such termination (*e.g.*, if the Medicaid applicant is acting as trustee or co-trustee at the time of such distribution), but should not be treated as an uncompensated transfer so long as the Medicaid applicant is not involved in such distribution.

2.2.9.7. Nevertheless, a distribution of principal which terminates income was considered an uncompensated transfer of the right to receive future income payments (even though the Medicaid applicant was not the trustee) in a New Jersey case reported by Whitenack, Mazart, and Spielberg.[45] In that case, the Medicaid applicant was the grantor of an income-only trust. Prior to submitting a Medicaid application, the grantor's son/trustee terminated the trust and retained the assets. Medicaid argued that the entire principal of the trust, as well as the income generated, should be counted as available resources. The final agency decision found that the transfer of assets took place when the applicant/grantor gave up his right to principal and transferred the assets to the trust, and found that the trust termination created an additional transfer of the income right that triggered a penalty period of Medicaid ineligibility and was valued based on the life expectancy of the applicant/grantor.[46] This secondary finding – that the trust termination created an additional transfer of the income right – is eliminated by the Living Trust Plus® Income-Only Trust because the Living Trust Plus® Income-Only Trust makes clear that the trustee has no duty to invest the trust corpus in income-producing assets and is not bound by any type of prudent investor act.

2.3. Can an Irrevocable Trust be Terminated?

2.3.1. Definition of *Irrevocable*.

2.3.1.1. Although the Living Trust Plus® is, by definition, irrevocable, it is important to understand that an "irrevocable" trust is simply a trust that can not be revoked unilaterally by the settlor. Under common law and under the Uniform Trust Code,[47] the term "revocable," as applied to a trust, means revocable by the settlor without the consent of the trustee or a person holding an adverse interest.

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[45] *J.S. v. Division of Medical Assistance and Health Services,* Docket No. HMA-4896-06. Final Agency Decision (3/22/07).

[46] *See* Whitenack, Mazart, and Spielberg, *The Revival of the Income-Only Trust in Medicaid Planning*, *supra*.

[47] Uniform Trust Code, Section 103 (Definitions).

2.3.1.2. *See infra*, section 2.5.2.1.1., for a list of states in which the Uniform Trust Code has been enacted.

2.3.2. Termination by Consent.

2.3.2.1. Under the common law[48] and the statutes of many states, including under Section 411 of the Uniform Trust Code, a non-charitable irrevocable trust can be terminated upon consent of the settlor and all trust beneficiaries.[49]

> **Warning:**
> Be sure to avoid collusion between the settlor and the trust beneficiaries whereby the trust beneficiaries agree in advance that they will revoke the trust for the benefit of the settlor.

2.3.2.2. Accordingly, the Living Trust Plus® can be terminated, and the assets returned to the settlor, if the settlor and all trust beneficiaries agree to the termination.

2.3.2.2.1. It is important, of course, that there be no collusion between the settlor and the trust beneficiaries whereby the trust beneficiaries agree in advance that they will revoke the trust for the benefit of the settlor.

2.4. Trustee Considerations.

2.4.1. Can settlor Serve as Trustee?

2.4.1.1. The most common question asked by clients wanting to establish a Living Trust Plus® is whether they, as the settlor of the trust, can also act as the trustee of the trust.

2.4.1.2. Although many commentators and attorneys in private practice take the position that a settlor can not serve as the Trustee of an irrevocable trust established by the settlor, there is no legal support for this conclusion in connection with a properly-drafted Income Only Trust such as the Living Trust Plus®. It may be better from a practical standpoint for the settlor to not serve as trustee, but there is no legal prohibition against the settlor so serving.

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[48] *See, e.g., Schroeder v. Woodward*, 116 Va. 506, 526-527, 82 S.E. 192, 199 (1914), which says that a trust "once created and accepted without power of revocation expressly reserved, can only be revoked by the consent of all the parties in interest." See also *Minot v. Tillon*, 64 N. H. 371, 10 Atl. 682; *Hallman v. McWilliams*, 70 Cal. 449, 11 Pac. 659; *Ewing v. Jones*, 15 L. R. A. 81.

[49] *See* Ian Marsh and Michael Ben-Jacob, *Irrevocable Trusts Can (Sometimes) Be Revoked,* Trusts and Estates Magazine (WG&L May 1, 2004).

2.4.2. Trustee is a Fiduciary.

2.4.2.1. It is basic hornbook trust law that a trustee stands in a fiduciary position with reference to the trust assets and cannot derive personal benefit from acting as trustee.[50] The trustee's creditors therefore have no claim to the trust assets to satisfy personal claims of the trustee. Clearly creditors can reach the income interest retained by the settlor, but creditors should not be able to reach the remainder interest in the trust because that interest is irrevocably vested in the remainder beneficiaries and the settlor has no ownership over the vested remainder.

2.4.2.2. This immediate vesting in the remainder beneficiaries is an important feature of a properly-drafted Income Only Trust such as the Living Trust Plus®, because without immediate vesting in remainder beneficiaries no one would have the right to enforce the terms of the trust, which would render the trust analogous to a revocable trust and would therefore provide no asset protection to the settlor.

2.4.3. Settlor Can Remove and Replace Trustee.

2.4.3.1. Just as a settlor can serve as the trustee of his own Living Trust Plus® Income Only Trust, so can the settlor retain the right to remove and replace someone else acting as trustee of the settlor's Living Trust Plus® Income Only Trust. The exact same logic applies.

2.4.4. Source of Confusion.

2.4.4.1. It is this author's belief that the reason many attorneys avoid naming the settlor as a Trustee of an irrevocable trust is because many attorneys are most familiar with using irrevocable trusts to hold life insurance, where the tax goal is to structure the trust so that the transfer to the trust is a completed gift so that the insurance proceeds are not brought into the settlor's estate pursuant to IRC § 2042.[51]

> **Practice Tip:**
> Consider giving the settlor of the income-only trust the right to remove and replace Trustees.

2.4.4.2. Attorneys drafting irrevocable life insurance trusts typically do not allow the settlor to serve as the Trustee, based on the lingering fear that serving as trustee will be deemed by the IRS to constitute "incidents of ownership" over the life insurance policy, thereby bring the policy proceeds into the settlor's gross estate pursuant to

[50] *See, e.g.,* Rev Rul 77-285, 1977-2 CB 213 (the trust instrument in question provided that the grantor could remove the trustee for any reason and substitute any other person – including the grantor – as trustee; held that even if the grantor becomes trustee, there would be nothing he could do to alter the amounts paid to recipients).

[51] This bias is reflected by the rampant use of the pejorative term "defective" in referring to "Grantor Trusts" as "Intentionally Defective Grantor Trusts" when in fact there is nothing "defective" about these trusts at all.

IRC § 2042, which would defeat the purpose of the irrevocable life insurance trust.[52]

2.4.4.3. With the Living Trust Plus® Income Only Trust, there is no concern about the settlor having "incidents of ownership" over any of the trust assets, because the trust is intentionally designed so that the contents of the trust are brought back into the settlor's estate for tax purposes.

2.5. Statutes, Cases, and Commentary.

2.5.1. Summary.

2.5.1.1. So long as the settlor retains rights to income only, then the underlying assets are protected from creditors, and are non-countable for Medicaid eligibility purposes, under the laws of most states. This statement is supported by the following sources:

2.5.2. Uniform Trust Code.

2.5.2.1. Section 505(a)(2) of the Uniform Trust Code states that "with respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit."[53]

2.5.2.1.1. As of May 2018, the Uniform Trust Code has been enacted in 32 jurisdictions: Alabama, Arizona, Arkansas, Colorado, District of Columbia, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin, Wyoming. It is under study in numerous other states.

2.5.2.1.2. Section 505(a)(2) of the Uniform Trust Code has been adopted in all of the enacting states without any significant change.

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[52] This fear, however, seems to be ungrounded; since PLR 200123034 (6/11/2001), attorneys have been drafting self-trusteed ILIT's. In PLR 200123034, a Grantor's transfer of assets into a self-trusteed irrevocable life insurance trust with Crummey provisions was determined by the IRS to be a completed transfer. The IRS found that Grantor had no right, title or interest in or power, privilege or incident of ownership in regard to any trust property, even though the Grantor was serving as the trustee of the trust and the Grantor retained the right to remove a trustee during Grantor's lifetime. *See* discussion on the ABA-PTL Archives, October 2007, at http://tinyurl.com/5ysdj3

[53] According to the Comment to § 505 of the Uniform Trust Code, this section does not address possible rights against a settlor who was insolvent at the time of the trust's creation or was rendered insolvent by the transfer of property to the trust. This subject is instead left to the State's law on fraudulent transfers. A transfer to the trust by an insolvent settlor might also constitute a voidable preference under federal bankruptcy law. The Uniform Trust Code also does not address creditor issues with respect to property subject to a special power of appointment. For creditor rights against such interests, the Comment to § 505 refers the reader to Restatement (Property) Second: Donative Transfers Sections [REST 2d PROP-DT] §§ 13.1-13.7 (1986). See also Sections 1.2.3 and 1.2.5 *infra*.

2.5.3. Restatement of Trusts, Second, Section 156.

2.5.3.1. The *Restatement (Second) of Trusts* Section 156 states the traditional rule as follows:

"(1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.

"(2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit."

2.5.4. Treatises Supporting Income-Only Trusts for General Asset Protection.

2.5.4.1. ***Asset Protection Strategies, Planning with Domestic and Offshore Entities*, page 3, American Bar Association Section of Real Property, Probate and Trust Law, edited by Alexander A. Bove, Jr. (2002)**: "Another possibility is to create a trust for the benefit of the grantor and other family members, but to limit the grantor's interest in the trust. For example, the grantor could create a trust and direct the trustee to pay her the income and retain a testamentary special power of appointment over the principal. If the power was not exercised, the principal could pass to the children. Although the grantor's creditors could attach the income interest in such a trust, the principal would be protected under the laws of most states."

2.5.4.2. **Esperti, Peterson & Keebler, *Irrevocable Trusts: Analysis With Forms* §14.01 (WG&L 2007)**: "If the beneficiary cannot compel distributions, a creditor or transferee ordinarily cannot compel distributions either."

2.5.4.3. ***Asset Protection: Legal Planning, Strategies and Forms*, by Peter Spero ¶ 6.08[2] (WG&L 2007)**: "Where the settlor retains only a limited interest in a trust, the portion thereof not retained is afforded some protection even though it is self-settled. The settlor's creditors can reach trust assets to the maximum extent that the trustee could distribute or apply such assets for the settlor-beneficiary's benefit." *(citing* 2 A. Scott & W. Fratcher, *The Law of Trusts* (4th ed. 1987), § 156.2, at 175. *In re Shurley*, 115 F.3d 333 (5th Cir. 1997)).

"If the settlor-beneficiary creates a remainder interest in another person, then the settlor-beneficiary's creditors will not be able to reach the remainder interest if the trustee cannot reach the corpus for the settlor-beneficiary's benefit." (*citing* G. Bogert & G. Bogert, *Trusts and Trustees* (2d rev. ed. 1992), § 223, at 453).

1.2.2.6. ***Asset Protection Strategies: Tax and Legal Aspects*, by Lewis D. Solomon and Lewis J. Saret (CCH Tax and Accounting, 2006):** "One strategy the planner should consider would be to establish an irrevocable trust that:

1. Gives the settlor an income interest in the irrevocable trust.
2. Gives the settlor a special power of appointment over the trust corpus, only in favor of the objects of the settlor's bounty (i.e. the settlor's spouse or children).
3. Gives the trustee the discretionary power to distribute trust corpus among the objects of the settlor's bounty. . . .
4. Includes a spendthrift provision in the trust instrument."

"This strategy has the following asset protection impact:

1. The settlor's retained income interest is exposed to the claims of creditors.
2. The settlor's creditor can not reach the trust corpus."

2.5.5. Treatises Supporting Income-Only Trusts for Medicaid Asset Protection.

2.5.5.1. **Begley, Jr. & Hook, *Representing the Elderly or Disabled Client: Forms and Checklists with Commentary*** ¶ 7.02[2] (WG&L 2008): Explains Richardson and Streimer letters referenced above.

2.5.5.2. **Frolik & Brown, *Advising the Elderly or Disabled Client*** (WG&L 2008) ¶14.04[5][c]: "If the grantor creates an irrevocable trust for his benefit or that of his spouse, the following rules apply:[54]

• "If the principal is payable to the grantor or the grantor's spouse, the principal is considered an available asset whether distributed or not, and transfers to a third party trigger a 60-month look-back period (36-month period prior to February 8, 2006);

• "If the principal cannot be distributed to the grantor or the grantor's spouse, it is not considered an available asset, but transfers to a third party trigger the 60-month look-back period;[55] and

• "If income can be distributed to the grantor or the grantor's spouse, it is considered income of the grantor, but the principal, if otherwise not distributable

[54] *Citing* 42 USC § 1396p(d)(3)(B).

[55] Note: this is an incorrect statement of the law, as it ignores the logical and presumptively correct interpretation of 42 USC § 1396p(d)(3)(B) by HCFA as evidenced in the Streimer letter referenced *supra* in section 2.5.5.1.

to or for the benefit of the grantor or the grantor's spouse, is not considered an available asset."

2.5.5.3. **Westfall & Mair, *Estate Planning Law and Taxation***, ¶13.05 (WG&L 2009): "With regard to an irrevocable trust, OBRA '93 provides that the trust principal is considered a countable resource if there are any circumstances under which payments from the trust principal could be made to or for the benefit of the settlor. If, on the other hand, the trustee may pay income but no principal to the settlor, it appears (although this issue has not been clarified by all state Medicaid agencies) that the principal will not be countable" (citations omitted).

2.5.6. Cases Supporting Use of Properly-Drafted Income-Only Truts.

2.5.6.1. ***Ware v. Gulda*, 331 Mass. 68, 117 N.E. 2d 137 (1957).** Held that where a settlor created for the settlor's own benefit a discretionary income-only trust (no principal distributions to the settlor were allowed), a creditor of the settlor could reach for satisfaction of a claim the maximum amount which the trustee could pay to the beneficiary or apply for the benefit thereof.

2.5.6.2. ***Paolozzi v. Commissioner*, 23 TC 182 (1954).** In this Tax Court case, the petitioner, Ms. Paolozzi, created a trust for herself where the trustee had discretionary power to distribute income only to the settlor. No principal distributions to the settlor were allowed in the trust. The Tax Court referred to both the above-quote Massachusetts Supreme Court case -- *Ware v. Gulda* -- and the above-quoted **Restatement of Trusts, Second** (section 2.5.3), in holding that the settlor's creditors could reach the maximum amount which, under the terms of the trust could be paid to the settlor. The Tax Court stated in its opinion:

> The rule we apply is found in Restatement: Trusts § 156 (2): "Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit." It has substantial support in authority. *Greenwich Trust Co. v. Tyson*, 129 Conn. 211, 224, 27 A. 2d 166; *Warner v. Rice*, 66 Md. 436, 8 A. 84; *Hay v. Price*, 15 Pa. Dist. R. 144; *Menken Co. v. Brinkley*, 94 Tenn. 721, 728-729, 31 S. W. 92; *Petty v. Moores Brook Sanitarium*, 110 Va. 815, 817, 67 S. E. 355; 27 L. R. A., N. S., 800; *Scott, Trusts*, § 156.2; *Griswold, Spendthrift Trusts* (2d ed.) § 481.

2.5.6.3. ***Estate of Uhl v. Commissioner,* 241 F. 2d 867 (7th Cir. 1957)**. In this Federal case arising out of Indiana, the United States Court of Appeals for the Seventh Circuit examined a trust that the decedent created during lifetime which did not require the trustee to pay him income but from which the trustee could pay him the income. The Seventh Circuit concluded that under Indiana law, which governed the trust, his creditors could not attach the trust assets.

2.5.6.4. **In the Matter of Irene Spetz v. New York State Department of Health, 190 Misc. 2d 297; 737 N.Y.S.2d 524; N.Y. Misc. LEXIS 29 (2002)**. This case arose out of the Supreme Court of New York, and involved a claim by the State Medicaid Agency ("Agency") that the assets of the applicant's spouse's irrevocable trust[56] were countable for purposes of Medicaid. The Agency challenged the trusts on several grounds:

2.5.6.4.1. Although the terms of the trust made it irrevocable, Mr. Spetz (the Medicaid applicant's husband) reserved to himself the right to change the beneficiary. This right was limited, in that he was specifically prohibited from naming himself, his spouse, creditors of himself or his spouse, the estates of himself or his spouse or creditors of those estates. The Agency argued that because of this right, the trust assets were in the "control" of Mr. Spetz and, therefore, must be considered in determining the eligibility of Mrs. Spetz to receive Medicaid benefits. The Agency also argued that the trust assets were available to Mr. Spetz because he could control the trustees under threat of appointing different beneficiaries if they refuse to comply. They asserted that the retention of the right to change beneficiaries is equivalent to control over the corpus of the trust.

2.5.6.4.2. The Court held that although it was conceivable that Mr. Spetz could bring pressure on the beneficiaries to make payments to or for Mrs. Spetz' benefit, the relevant law stated that the availability of assets, for Medicaid eligibility purposes, depends upon the "trustee's authority, under the specific terms of the trust agreement." The Court found that trustees of this trust had no such authority. The Court also stated that "[a]lthough the trustees and beneficiaries are currently the same people, that is not necessarily so under the terms of the trust, as respondents have pointed out, and, in any event, their roles as trustees and beneficiaries must be considered as legally separate."

2.5.6.4.3. The Agency also argued that under New York law (section 7-1.9 of the Estates, Powers and Trusts Law, which is similar to section 411 of the Uniform Trust Code), any trust can be revoked, provided that the beneficiaries consent, in writing, to the revocation. Thus, the Agency argued, the assets of the trust should be considered available to the Medicaid applicant because her husband could seek the consent of the trust's beneficiaries to revoke the trust, thus placing the corpus of the trust back in his hands. This is especially true, the Agency argued, since Mr. Spetz could possibly use his power to change beneficiaries in collusion with someone willing to revoke the trust.

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[56] The trust at issue allowed distribution only to the beneficiaries. The trustees had no power to pay income to or for the benefit of the settlor or his spouse. Although this is slightly different from the typical income-only trust, which does allow income to the settlor, the design of the this trust otherwise seems virtually identical to most income-only trusts, and the findings and conclusions of law in this case apply equally to income-only trusts..

2.5.6.4.4. The Court held that the speculative possibility of a revocation pursuant to New York law did not render the corpus of the trust "potentially available" to the petitioner, as there was no evidence presented that the beneficiaries would consent to such a revocation. "To hold otherwise would eviscerate the federal and state statutes providing, in detail, for the protection of assets through the use of irrevocable trusts, since every trust would be presumed to be revocable under section 7-1.9." The Court also found that the "claim that Mr. Spetz could somehow use his power to change the beneficiary in collusion with someone willing to revoke the trust is entirely speculative."

2.5.6.5. **Verdow v. Sutkowy, 209 F.R.D. 309 (N.D.N.Y. 2002)**. In this case, a federal court faced with a similar fact pattern to *Spetz,* except in the form of a federal class action, six elderly nursing home residents in New York State who created irrevocable, income-only trusts were denied Medicaid benefits because the trusts contained provisions reserving a limited power of appointment. County and state Medicaid officials determined that a limited power of appointment makes the assets of a trust an available resource for purposes of determining Medicaid eligibility.

2.5.6.5.1. The plaintiffs brought a suit under 42 U.S.C. § 1983 for themselves and others similarly situated against county and state Medicaid officials, alleging that consideration of the trust assets as an available resource is unlawful because there are no circumstances under which they could be paid the assets. Just as in *Spetz*, Medicaid officials argued that the plaintiffs could utilize their retained power to change beneficiaries to individuals amenable to revoking an otherwise irrevocable trust.

2.5.6.5.2. The U.S. District Court for the Northern District of New York granted the plaintiffs' motions for class certification and summary judgment, holding that "defendant's denial of plaintiffs' Medicaid benefits because they allegedly are potential beneficiaries of self-settled trusts containing limited powers of appointment exceeds the limits of federal law." The court further ruled that "absent evidence of bad faith or fraud, the decision of whether or not to provide Medicaid benefits should not be based upon the remote possibility of collusion."

2.5.6.6. All of the cases set forth in section 2.5.7 also support the conclusion that where a person creates a trust for his own benefit, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

2.5.7. Specific Features of the Living Trust Plus® Income Only Trust.

2.5.7.1. **Retained General Powers Prohibited.**

2.5.7.1.1. When a person transfers property in trust for himself for life and reserves a general power to change the beneficiaries, the interest subject to such retained power (even if the power is not exercised), and the settlor's retained life interest, can both be subjected to the payment of the claims of creditors of such person and claims against his estate to whatever extent other available property is insufficient for that purpose. *United States v. Ritter*, 558 F.2d 1165, 1167 (4th Cir. 1977).

2.5.7.1.2. In *Petty v. Moores Brook Sanitarium*, 110 Va. 815 (1910), the decedent created a "spendthrift trust" for his own benefit and retained a general power of appointment over the remainder. In denying creditor protection to the trust, the Court stated that "[in all trusts there must be a *cestui que trust*, and it is manifest from the deed that [the decedent] was to have the sole beneficial use of the property conveyed, certainly during his life, with power to dispose of what remained at his death by will." *Id.* at 817.

2.5.7.2. **Retained Limited Powers.**

2.5.7.2.1. A trust settlors often retains a limited power to change beneficiaries for a variety of purposes:

2.5.7.2.1.1. To maintain the ability to respond to changing family circumstances;

2.5.7.2.1.2. To respond to changing financial needs;

2.5.7.2.1.3. To prevent the imposition of a gift tax;

2.5.7.2.1.4. To ensure a step-up in tax basis on his or her death.

2.5.7.2.2. As a matter of both common law doctrine and the practicalities of the situation, the donee of a limited power of appointment is not the owner of the appointive assets. The donee is in a fiduciary position with reference to the power and cannot derive personal benefit from its exercise. The donee's creditors have no more claim to the appointive assets than to property which the donee holds in trust. It is immaterial whether or not the donee exercises the power.[57]

2.5.7.2.3. If the donee formerly owned the appointive assets covered by the non-general power *and transferred them in fraud of the donee's creditors*, reserving the non-general power, *the creditors can reach the appointive assets under the rules relating to fraudulent conveyances*. The fact that a non-general power was reserved by the donee in such fraudulent conveyance does not increase or decrease the ability of the creditors to reach the appointive assets.[58]

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[57] REST 2d PROP-DT § 13.1(b), cmt. a.

[58] REST 2d PROP-DT § 13.1(b).

2.5.7.2.4. **Illustration:** O by deed transfers property to T in trust. T is directed to pay the net income to O for life. In addition, T is directed "to distribute the trust property to, or hold the same for the benefit of, O's issue who are living from time to time, in such amounts and proportions and for such estates and interests and outright or upon such terms, trusts, conditions, and limitations as O shall appoint during O's lifetime; and on O's death, to the extent the trust property is not otherwise disposed of by an exercise of O's power to appoint, the trust property shall pass to O's issue then living, such issue to take *per stirpes*, and if no issue of O is then living, to the X charity."[59]

2.5.7.2.5. **Explanation:** O is both the donor and donee of O's non-general power to appoint. O's creditors can reach the life income interest under the trust which O owns. They can also reach the property that is subject to O's non-general power **if the transfer is in fraud of O's creditors under the governing law as to fraudulent conveyances**.[60]

2.5.7.2.6. **Gift in Default of Appointment to Donee's Estate**: If the gift in default of appointment is to the donee's estate, the donee's power, though in form a non-general power, is in substance a general power, and is therefore not protected from the donee's creditors.[61]

2.5.7.2.7. **Supportive Case Law:** Commenting on the limited number of cases involving the point, the American Law of Property concludes that this is likely due to "a general acknowledgment of the rather obvious principle" that property under a non-general power is not available to creditors of the donee.[62]

2.5.7.2.7.1. One of the few cases is *Egbert v. De Solms*, 218 Pa. 207, 67 A. 212 (1907). In that case a husband and wife executed a trust whereby the wife was to receive the income from the trust during her lifetime, to be followed after her death by a life interest for the husband, and at his death the principal to be divided among their issue in such shares as the husband should by will appoint. The court held that while the income payable to the parents was subject to the payment of their debts,

[59] REST 2d PROP-DT § 13.1(b).

[60] REST 2d PROP-DT § 13.1(b).

Note that the rule of REST 2d PROP-DT §13.1 applies to non-general powers, i.e., powers that are not exercisable in favor of any one or more of the following: the donee of the power, the donee's creditors, the donee's estate, or the creditors of the donee's estate. *See* Reporter's Note to § 13.1.

Note also that in bankruptcy law, where there has been a tendency to go further in allowing creditors access to property over which the debtor has a power of appointment than under the common law, property covered by a non-general power has never been subject to the claims of creditors. See *Drummond v. Cowles*, 278 F. Supp. 546 (D. Conn. 1968) and the Reporter's Note to REST 2d PROP-DT, § 13.6, item 3.

[61] REST 2d PROP-DT §13.1(c).

[62] REST 2d PROP-DT §13.1(c), citing 5 *American Law of Property* § 23.15 (A.J. Casner ed. 1952).

the issue's remainder estate could not be defeated. "Except as against existing creditors, or those in specific contemplation in the immediate future, the [settlors] could have conveyed a present absolute estate to their children; and *a fortiori* they could convey an estate in remainder." *Id.* at 209, 67 A. at 212-13.

2.5.7.2.7.2. The fact that a donee exercises the power, while significant when dealing with a general power, makes no difference when the power is a limited one; creditors cannot reach the appointive property in either case.

2.5.7.2.7.2.1. In *Prescott v. Wordell*, 319 Mass. 118, 65 N.E.2d 19 (1946), the executors contended that, because the donee exercised her non-general power in her will, the will had the effect of making the appointed property assets of her estate in so far as her creditors were concerned. The court, pointing to § 326 of the first Restatement of Property, held that since the donee had no power to appoint to her own estate or for the benefit of her creditors, her exercise of the power did not subject the appointed property to the payment of her debts.

2.5.7.2.7.2.2. The Maryland high court in *Price v. Cherbonnier*, 103 Md. 107, 63 A. 209 (1906), held invalid an attempted testamentary appointment to certain creditors since they were not objects of the donee's non-general power. Further, the attempted exercise did not render the property assets of the estate subject to the claims of creditors. Dictum to the same effect (that ineffectively appointed property under a non-general power cannot be reached by the donee's creditors) appears in *Fiduciary Trust Co. v. First National Bank of Colorado Springs*, 344 Mass. 1, 7, 181 N.E.2d 6, 10 (1962).

2.5.7.2.7.2.3. In a more recent Maryland case, the Court held that a settlor's retained limited power of appointment is not sufficient to allow the creditor to seize trust assets. In *United States v. Baldwin*, 283 Md. 586, 391 A.2d 844 (1978), Baldwin had transferred property to a trust, reserving to himself the right to receive the income from the trust property for life and a power of appointment by will to designate those persons who would receive and enjoy the remainder after his death. The Maryland Court of Appeals held in *Baldwin* that the power of appointment, under Maryland law, was a special or limited power which did not permit Baldwin to appoint the corpus to his own estate or to his creditors. Such a limited power of appointment of the corpus, coupled with the life estate, did not give Baldwin such a property interest in the corpus as to subject it to the claims of his creditors. *Id.*

2.5.7.2.7.2.4. The Connecticut case of *Ahern v. Thomas*, 248 Conn. 708, 739, 733 A.2d 756, 775 (1999) involved a nursing-home resident who appealed denial of her Medicaid application following administrative determination that the principal of the trust she had established was an available resource for purpose of calculating her Medicaid eligibility. The trial court reversed. Affirming, the Connecticut high court held that because the trust instrument did not provide trustees with authority or discretion to distribute trust principal to settlors, the principal of the trust was not an available resource.

2.5.7.2.7.2.5. In another Connecticut case, after a dissolution of marriage was granted, a Connecticut intermediate appeals court reversed and remanded, holding that no portion of the husband's spendthrift trust assets could be included in the marital estate and awarded to the wife, as the husband had only a limited power of appointment and no interest in the appointive assets of the trust. *Cooley v. Cooley*, 32 Conn. App. 152, 161, 628 A.2d 608, 614, *cert. denied* 228 Conn. 901, 634 A.2d 295 (1993).

2.5.7.2.7.2.6. In a Georgia case, *Avera v. Avera*, 253 Ga. 16, 315 S.E.2d 883 (1984), a settlors created a trust whereby he would receive the income of the trust while retaining a limited power of appointment. The trustee could invade the corpus of the trust for the settlor's benefit, but that power was subject to an ascertainable standard. The Supreme Court of Georgia held that principal of the trust could not be invaded to satisfy a claim against the settlors arising out of a divorce since the trustee's discretion to make distributions to the settlors was limited by an ascertainable standard. The court so held even though the settlors retained a limited power of appointment. The court also noted that there was always one other beneficiary of the trust, even though the settlors could change that beneficiary.[63]

2.5.7.2.7.2.7. The New York case of *Spetz*[64] and the New York federal case of *Sutkowy,*[65] both previously discussed, were Medicaid cases involving irrevocable trusts with retained lifetime limited powers of appointment. The Medicaid Agency in both cases claimed that the settlors could use their retained lifetime limited power to change the beneficiaries to individuals willing to revoke the trust. Both courts, relying on the same logic, rejected this argument as being entirely speculative, holding that denial of Medicaid benefits could not be based upon a remote possibility of collusion absent bad faith or fraud.[66]

2.5.7.2.8. **Case Allowing Annuity to be Owned by Trust**

2.5.7.2.8.1. In **Heyn v. Director of the Office of Medicaid** (Mass. App. Ct., No. 15-P-166, April 15, 2016), the Massachusetts Court of Appeals ruled that the state

[63] REST 2d PROP-DT §13.1© (also citing *DiMaria v. Bank of Cal. Nat'l Ass'n*, 237 Cal. App. 2d 254, 46 Cal. Rptr. 924 (1965) (self-settled trust could not be reached where trustee's power to invade and distribute to settlor/beneficiary was limited by an ascertainable standard)).

[64] *See supra*, section 2.5.6.4.

[65] *See supra*, section 2.5.6.5

[66] *Supra*, sections 2.5.6.4 and 2.5.6.5.

Medicaid agency erred when it determined that the assets in an irrevocable income-only trust were countable because, in the agency's opinion, the trustee's ability to purchase an annuity with trust assets allowed the trustee to distribute trust principal to the beneficiary. The court found that "[o]ut of each annuity payment, only the investment income portion would be available for distribution to the grantor from the trust; that portion of each payment representing a return of capital would be required by the trust instrument to be retained in the trust. The income portion available for distribution in such circumstances would be no different in character than interest earned on a certificate of deposit . . . In all events, the trust principal is preserved in the trust, and is not available for distribution to the grantor under the governing provisions of the trust."

2.5.7.2.9. **Cautionary Case Law.**

2.5.7.2.9.1. According to treatise author Peter Spero (a certified specialist in tax law and a member of the California bar), the retention of a limited power of appointment by a transferor will be taken into account by courts in determining whether the transfer of property is effective or an avoidable fraudulent transfer.[67]

2.5.7.2.9.1.1. **Note:** This writer, as supported by REST 2d PROP-DT §13.1, believes that Mr. Spero, and many of the courts in the opinions he cites (presented below), have misconstrued the doctrine of fraudulent conveyance by improperly intertwining the conveyance itself with the retained powers held by the conveyor, which are two completely separate issues and must be viewed separately.

2.5.7.2.9.2. In resolving this issue, Mr. Spero states that "courts often consider the incidents of ownership, which include not only present enjoyment, but also the power to ultimately dispose of the property. The more incidents of ownership the settlors retains, the more likely the arrangement will not be effective to secure the property from the settlor's creditors."[68]

2.5.7.2.9.2.1. **Note:** Again, this writer believes that Mr. Spero and some courts are confused. This writer, as supported by REST 2d PROP-DT §13.1, disagrees that "the power to ultimately dispose of the property" is necessarily an "incident of ownership." If the "power to ultimately dispose of the property" is bestowed via a **general** power, then it would certainly constitute an "incident of ownership" sufficient to subject the trust the property to creditors of the power holder. However, if the "power to ultimately dispose of the property" is bestowed via a **limited** power, then it would not constitute an "incident of ownership" and

[67] Spero, *Asset Protection: Legal Planning, Strategies and Forms* ¶13.10[3].

[68] Spero, *Asset Protection: Legal Planning, Strategies and Forms* ¶13.10[3].

therefore should not subject the trust the property to creditors of the power holder.

2.5.7.2.9.2.2. In the Pennsylvania case of *In re Nolan*, 218 Pa. 135, 67 A. 52 (1907) *(see supra* Section 2.2.6), the settlors retained the power to appoint the remainder **and the trustee had the power to reconvey the property to the settlors**. In holding that no creditor protection was available, the court unfortunately did not specifically refer to the trustee's power to reconvey the property to the settlors, but this author believes that it was exactly that power to reconvey that caused the court to negate the asset protection nature of the underlying trust. The Court stated:

"It is against public policy, and not consonant with natural justice and fair dealing as between debtor and creditor, that a settlors should be permitted to play fast and loose with his property, in such a manner as to have the use of the income during life, and the right to disposing of the principal by will at any subsequent time he chooses to exercise the power, thus giving him all of the substantial benefits arising from the ownership thereof while he has safely put his property beyond the reach of creditors." [69]

2.5.7.2.9.3. Similarly, in *First National Bank v. Schwab*, 194 So. 307, 309 (1940), the settlors transferred property to a trust while retaining a life estate, and the power to change the trustee and beneficiary. The court held that these retained powers established that he did not intend to place property out of his control and that the transfer was a mere contrivance that was not effective with regard to his creditors.[70]

2.5.7.2.9.4. Further, Mr. Spero says that "it has been observed that a power to change beneficiaries is similar to a power to terminate the trust and revest corpus in the settlors, since generally the beneficiaries and the settlors can terminate the trust. If the settlors selects the beneficiary, such as a close relative, in advance, and creates an agreement or understanding with the beneficiary, he would effectively have the power to revoke the trust."[71]

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[69] Spero, *Asset Protection: Legal Planning, Strategies and Forms* ¶13.10[3]. Note that the *In re Nolan* Court did not mention in its holding that the trustee had the power to reconvey the property to the settlors. This writer presumes that it was the trustee's power to reconvey the property to the settlors, in addition to the limited power of appointment, that irked the Court and resulted in this anomalous holding.

[70] In the *Schwab* case, the settlor not only retained a limited power of appointment, but also the trustee was given the power to reconvey the property to the settlor. This writer presumes that it was the trustee's power to reconvey the property to the settlors, in addition to the retained limited power of appointment, that particularly irked the Court and resulted in this anomalous holding.

[71] Spero, *Asset Protection: Legal Planning, Strategies and Forms* ¶13.10[3], *citing* annotation, "Exercise of Power to Appoint Validity," 115 A.L.R. 930, 937 (1938) (an appointment under a limited power is void if made pursuant to a prior agreement that the property appointed will be paid back to the appointer).

2.5.7.2.9.5. However, absent proof of such advance agreement or understanding, and absent proof that the beneficiaries would actually consent to such a revocation, it is extremely unlikely that a court would invalidate such trust. As the Court noted in the case of *Spetz v. New York State Department of Health*,[72] to hold otherwise would eviscerate the federal and state statutes providing, in detail, for the protection of assets through the use of irrevocable trusts, since every trust would be presumed to be revocable under section 411 of the Uniform Trust Code and related state statutes and common law.

2.5.7.2.9.6. **Cautionary Cases About Retaining the Right to Live in the Home.** In *Doherty v. Dir. of the Office of Medicaid* (74 Mass.App.Ct. 439, 441, 908 N.E.2d 390, 2009) the court held that if an irrevocable trust allows the Medicaid applicant to use and occupy the home, then home is an 'available' asset. This is why in the Living Trust Plus® we never have the trust permit the settlors to reside in the property. But more importantly, in *Doherty*, the Appeals Court concluded the trust's principal was a countable asset because the trust, despite some language restricting the grantor's access to the principal, allowed the trustees to invade the trust's principal and income when necessary to ensure the grantor's "quality of life," "comfort," and "respond to her changing life needs."

2.5.7.2.9.6.1. Clearly all of these provisions allowing the trustees to invade the trust's principal when necessary to ensure the grantor's "quality of life," "comfort," and to "respond to her changing life needs" are inconsistent with a Medicaid Asset Protection Trust.

2.5.7.2.9.7. In *Nadeau v. Director of the Office of Medicaid* (Mass. Super. Ct , No. 14-CV-02278C, Dec. 30, 2015)[73], Lionel and Jacqueline Nadeau, husband and wife, transferred their primary residence in Massachusetts into an irrevocable income only trust on March 27, 2001. The principal was to be held in trust until the termination of the trust upon the death of the surviving spouse or when the trustee, in her sole discretion, determined that the trust should be terminated. Upon termination, the principal of the trust was to be distributed to the Nadeaus' children. In the trust instrument, the Nadeaus specifically retained the ability to use and occupy their residence. The Nadeaus also retained the ability to appoint "all or any part of the trust property then on hand to any one or more charitable or non-profit organizations over which [they] have no controlling interest.[74]" The trust

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[72] *See infra* section 2.5.6.4.

[73] https://www.dropbox.com/s/i5rkr7nqqt7zsij/Nadeau%20Superior%20Court%20Case%202015.pdf?dl=0

[74] This author believes this type of provision is problematic for many reasons, including the fact that a trust naming possible charitable beneficiaries cannot be terminated upon consent of all "interested parties" without involving the State Attorney General to protect the interest of possible charitable beneficiaries. Also, many nursing homes are non-profit entities which means it is conceivable that money could be distributed to a non-profit nursing home which could somehow be seen to benefit the Settlor if the Settlor is a resident of that nursing home. This in fact

also provided that the trustee could distribute principal to the Nadeaus "to the extent that the income of the trust generates a tax liability" to enable the Nadeaus to pay any tax liability generated by the income distributions[75]. In 2014, Mr. Nadeau was admitted to a nursing home and applied for Medicaid benefits in Massachusetts. His application was denied because of excess resources as a result of the value of the residence held in trust. In upholding the denial of the Medicaid application, a hearing officer reasoned that the use and occupancy clause rendered the assets of the trust available to Mr. Nadeau, and thus that the corpus was fully countable to him, despite his having no ability to receive distributions of trust principal. The hearing officer declined to apply the "any circumstances" test and instead determined that because "the appellant's former home is available to appellant by virtue of the fact that he can use and occupy the home and he is an income beneficiary of the Trust which is funded with the home," the state Medicaid regulations direct that such principal is countable for Medicaid eligibility purposes. The Mass. Superior Court upheld the decision of the hearing officer.

2.5.7.2.9.8. **Cautionary Case About Retaining a Life Estate in the Home.** In another problematic Massachussets case, *Daley v. Sudders* (Mass. Super. Ct., No. 15–CV–0188–D, Dec. 24, 2015)[76], a Massachusetts trial court made a very bad ruling that a Medicaid applicant's irrevocable trust was an available asset because the applicant retained a life estate in the condominium owned by the trust. In December 2007, Mr. and Mrs. Daley transferred their condominium into an irrevocable trust naming their son and daughter as trustees. The deed retained a life estate for Mr. and Mrs. Daley permitting them to live in the condominium, which they did for six years, when Mr. Daley had to move to a nursing home in December 2013. His application for Medicaid benefits was subsequently denied because the trust was considered a countable asset. On appeal to the Superior Court, the Court upheld Medicaid's denial, citing the above decision in *Doherty v. Dir. of the Office of Medicaid* (74 Mass.App.Ct. 439, 441, 908 N.E.2d 390, 2009) to the effect that: "If a Medicaid applicant can use and occupy her home as a life tenant, then her home is 'available.'" The court concluded that Mr. and Mrs. Daley's condominium was available to them because they retained life estates under the deed, and continued to use and live in it after establishing the Trust. In other words, the Court here took a provision in the deed retaining property rights for Mr. and Mrs. Daley to invalidate a trust which apparently did not give them the right to use and occupy the condominium. This is unlike the Doherty trust in which the right to use and occupy the property was in the trust rather than the deed.

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was mentioned by the court on appeal, discussed later.

[75] This author believes this type of provision is problematic because it clearly allows distribution of principal which is inconsistent with a Medicaid Asset Protection Trust because it does not pass the "any circumstances" test.

[76] http://masscases.com/cases/sjc/477/477mass188.html

2.5.7.2.9.9. However, and this may be the real point of the case, the Court then reviews certain provisions in the trust which permit the trustees to use income and principal to pay certain trust expenses -- taxes, insurance premiums -- and a right of substitution, to conclude that "the Daleys had access to both the Trust principal and income." The right of substitution is fatal in this author's opinion, because the right to substitute assets of equal or greater value clearly (in the warped mind of Medicaid eligibility workers) allows the Settlors to "obtain principal" from the trust, even though it is by way of substitution and our lawyer minds rebel sharply against this concept.

2.5.7.2.9.10. **Happy Ending with Regard to the Real Estate Issues in Nadeau and Daley.** Thankfully, the Daley case was appealed to the Supreme Judicial Court of Massachusetts, and in *Daley v. Sec'y of the Exec. Office of Health & Human Servs.*, 477 Mass. 188, 74 N.E.3d 1269 (Mass 2017), the state's highest court granted Daley's application for direct appellate review and, on it's own motion, transferred Lionel C. Nadeau's appeal to this court to be decided together. The Supreme Judicial Court of Massachusetts found that "neither the grant in an irrevocable trust of a right of use and occupancy in a primary residence to an applicant nor the retention by an applicant of a life estate in his or her primary residence makes the equity in the home owned by the trust a countable asset for the purpose of determining Medicaid eligibility for long-term care benefits." The Supreme Judicial Court of Massachusetts vacated both the Daley and the Nadeau judgments and remanded the matters to MassHealth for findings regarding two other possible sources of countable assets contained in the trusts.

2.5.7.2.9.10.1. In the remand, the Court pointed out that both the Daley Trust and the Nadeau Trust allowed the trustee to pay the grantor's tax liability arising from income distributions to the grantors from the corpus of the trust (which, I believe, could be a dealbreaker, because these provisions clearly violate the "any circumstances" test) and the court remanded both cases to MassHealth to determine whether this portion of the corpus is a countable asset under the "any circumstances" test and to ascertain under § 1396p(d)(3)(B)(i) the size of the "portion of the corpus from which ... payment to the individual could be made."

2.5.7.2.9.10.2. Also in the remand of the Nadeau case to MassHealth, the Supreme Judicial Court of Massachusetts told the agency to consider whether Mr. Nadeau's ability to appoint assets to a nonprofit organization or charity could be interpreted to mean that the corpus could be appointed for his care costs. The Court noted that up to one-fourth of nursing homes in the state were nonprofit organizations and therefore it was at least conceivable that the power of appointment for the payment of care costs could be exercised in favor of a grantor in a nonprofit nursing home. According to the author of a NAELA Case Note[77] on these two cases, "a favorable Board of Hearings decision on this case was

[77] https://www.naela.org/NewsJournalOnline/OnlineJournalArticles/OnlineApril2018/CaseNoteNeeley.aspx

released in August 2017.[78]"

2.5.7.2.9.11. **Another cautionary case came from New Hampshire's highest court on July 12, 2016** (*Estate of Thea Braiterman, N.H., No. 2015-0395*), ruling that a Medicaid applicant's irrevocable trust was an available asset, even though the applicant was not a beneficiary of the trust, because the applicant supposedly retained a degree of discretionary authority over the trust assets. Ms. Braiterman created an irrevocable trust in 1994, naming herself and her son as trustees and her children as beneficiaries. In 2008, Ms. Braiterman resigned as trustee, but the trust authorized her to appoint additional and successor trustees, including appointing herself. The trust also gave Ms. Braiterman the ability to appoint any part of the income of the trust to any of the beneficiaries and, as interpreted by the court, *did not limit her ability to impose conditions on the appointment of principal to the beneficiaries*. Ms. Braiterman entered a nursing home and applied for Medicaid. The state determined that the trust assets were countable resources and denied her benefits. After a hearing, Ms. Braiterman appealed the agency's decision to court. The New Hampshire Supreme Court affirmed the denial of benefits, holding that the trust was an available asset because the court believed that Ms. Braiterman retained a degree of discretionary authority over the trust. The court correctly pointed out that an irrevocable trust is a countable asset if there are *any* circumstances in which payment can be made to the applicant. The court rules that there was nothing in the trust "to preclude [Ms. Braiterman] from requiring her children, as a condition of their receipt of the Trust principal, to use those funds for her benefit."

2.5.7.2.9.12. The *Braiterman* court specifically addressed the *Verdow* and *Spetz* cases cited herein. However, the *Braiterman* court pointed out that, unlike the grantors in *Verdow* and *Spetz*, the applicant in this case retained broad powers over the Trust, in her capacity both as donor and as Trustee, including the power to make a distribution to a legatee conditioned upon that legatee using the distribution for the applicant's benefit. In addition, the *Braiterman* court stated that "although there is no evidence of collusion in this case, collusion is arguably encouraged by Clause 4.1.1, which provides that, in the event that the Trust's existence disqualifies the applicant for Medicaid benefits, the applicant 'suggests' that the Trust be terminated and that the Legatees (her children) use Trust assets 'to supplement the income and . . . governmental benefits and services to which [she] may be entitled.' By virtue of these provisions and others, the circumstances under which payments from the Trust could be made to benefit the applicant in this case are not 'entirely speculative,' *Verdow*, 209 F.R.D. at 316, but, rather, are specifically anticipated under the Trust Agreement."

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[78] *citing* Off. of Medicaid, Bd. of Hrgs., App. 1614874 (Aug. 18, 2017).

2.6. Taxation of the Income Only Trust and Total Protection Trust.

2.6.1. Income Tax.

2.6.1.1. Because all trust income flows through the trust to the settlors using the Living Trust Plus® Income Only Trust, this trust is considered by the IRS to be a "grantor trust."[79] Through use of the Living Trust Plus® Income Only Trust, the ordinary income of the trust is paid directly to the settlor/grantor and the tax will be paid at the settlor's tax rate, rather than by the trust at the compressed trust tax rates.

2.6.1.2. The Living Trust Plus® Income Only Trust and the Total Protection trust has the Settlor retain a limited testamentary (and possibly lifetime) power of appointment to change the beneficiaries of the trust, which also causes grantor trust status. The ability of the Settlor to change beneficiaries and make distributions of income and corpus from the Total Protection Trust makes both types of trusts Grantor Trusts as to the Settlor as to the entire trust (IRC §674(a) and Treas. Regs. §1.674(d)-2(b)). Pursuant to IRC §674(a), "The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party."

2.6.2. Income Tax Reporting.

2.6.2.1. A separate taxpayer identification number is not required and a separate tax return (Form 1041) need not be filed by the trustee.[80]

2.6.2.2. However, for general asset protection purposes, it may be preferable for the trust to obtain a separate tax identification number so that potential creditors will clearly see the trust as a separate entity.

2.6.2.3. The Rules for reporting income are contained in the Instructions for Form 1041, under the section entitled "Grantor Type Trusts." The trustee does not show any dollar amounts on the form itself dollar; amounts are shown only on an attachment to the form (typically called a Grantor Trust Statement) that the trustee or tax preparer files. The trustee should not use Schedule K-1 as the attachment nor issue a 1099.

> **Practice Tip:**
> Consider preparing the Grantor Tax Statement for the Living Trust Plus®, at least for the first year.

[79] IRC § 677 and Treas. Reg. §1.671-2.

[80] *See* IRS Instructions for From 1041, "Optional Method 1" under "Special Filing Instructions for Grantor Type Trusts."

2.6.3. Gift Tax.

2.6.3.1. Because the Living Trust Plus® is designed so that the settlors retain a limited power of appointment in the trust corpus, transfers to the Living Trust Plus® are not considered completed gifts for gift tax purposes because a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves.[81]

2.6.3.2. When a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift.[82]

2.6.3.2.1. However, when the settlor does not retain the right to receive the income from the trust (as is the case with the Veterans Version of the Living Trust Plus® (also called the Living Trust Plus® Total Protection Trust or the Veterans Trust Plus™ – see 2.7) – a trust designed to protect assets in connection with the Veterans Aid and Attendance Benefit), then the settlor's retained limited power of appointment over the trust corpus arguably must be a lifetime power of appointment and not just a testamentary power of appointment. IRS Memorandum 1208026 says that the retention of testamentary limited power of appointment is not in itself sufficient to make a gift incomplete. A "testamentary power does not (and cannot) affect the trust beneficiaries' rights and interests in the property during the trust term. Rather, a trustee with complete discretion to distribute income and principal to the term beneficiaries may, in exercising his discretion, distribute some or all of the trust property during the trust term. The holder of a testamentary power has no authority to control or alter these distributions because his power relates only to the remainder, *i.e.*, the property that will still be in the trust when the beneficial term interests are terminated. *Citing* Bowe-Parker, Page on the Law of Wills § 45.12 (1962), Bittker and Lokken, Federal Taxation of Income, Estate and Gifts ¶ 226.6.7 (2011); Howard M. Zaritsky, Tax Planning for Family Wealth Transfers (4th ed. 2011 Cum. Supp. No. 2) ¶ 3.03[1].

2.6.3.3. In the case examined in IRS Memorandum 1208026, the Donor transferred property to the Trust and retained a testamentary limited power to appoint so much of it as would still be in the Trust at his or her death. The Donors did not retain any right to receive income or any right to affect the beneficial term interests of their children, other issue, and their spouses (and charities) during the Trust term. Accordingly, the IRS concluded that with respect to those interests, the Donors fully divested themselves of dominion and control of the property when they transferred the property to the Trust.

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[81] Treas. Reg. § 25.2511-2(b).

[82] Treas. Reg. § 25.2511-2(b).

2.6.4. Gift Tax Reporting.

> **Practice Tip:**
> Consider preparing the Gift Tax Return and attachments for transfer of assets into the Living Trust Plus®.

2.6.4.1. Even though the transfer of assets into the trust is not considered a taxable gift, pursuant to Treas. Reg § 25.6019-3 a Form 709, U.S. Gift (and Generation Skipping Transfer) Tax Return should still be filed in the year of the initial transfer into the trust.[83] On the Form 709, the transaction should be shown on the return for the year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument(s) of transfer and a copy of the trust, should be submitted with the return.[84] The penalty for not filing a gift tax return is based on the amount of gift tax due, so if there is no amount due there should be no penalty for failure to file. Nevertheless, a gift tax return should be filed pursuant to Treas. Reg § 25.6019-3. Additionally, the filing of a gift tax return could provide additional evidence to future creditors, including Medicaid, that a completed transfer was in fact made despite the fact that the transfer was not considered by the IRS to be a completed gift for tax purposes.

2.6.4.2. Neither Treas. Reg § 25.6019-3 nor the IRS Form 709 Instructions reveal how to report an incomplete gift. However, Treas. Reg § 301.6501(c)-1(f)(2) provides in relevant part as follows:

"A transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed under this paragraph (f)(2) if the return (or a statement attached to the return) provides the following information—

(I) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and each transferee;

(iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument."

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[83] *See* Treas. Reg § 25.6019-3, which states that "[i]f a donor contends that his retained power over property renders the gift incomplete . . . and hence not subject to tax . . . , the transaction should be disclosed in the return for the . . . calendar year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument of transfer, shall be submitted with the return. . . [along with] additional documents the donor may desire to submit."

[84] Treas. Reg § 25.6019-3.

2.6.4.3. Although the transfer to the trust is an incomplete gift for gift tax purposes, if the trustee later distributes corpus from the trust to one or more of the beneficiaries, the tax result of such distribution is that a completed gift has now been made from the trust settlor to the beneficiary. Accordingly, a gift tax return should be filed by the settlor for the tax year of such distribution if the amount of such distribution exceeds the annual exemption amount.

2.6.5. Estate Tax.

2.6.5.1. Where the settlor has retained the right to receive the income from the trust (as with the Income Only Trust, the corpus of the trust is taxable in the settlor's estate upon death under IRC Section 2036, which says that "[t]he 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 . . . under which he has retained for his life . . . the possession or enjoyment of, or the right to the income from, the property . . . ."[85]

2.6.5.2. Estate inclusion is also brought about by IRC section 2038 for both the Income Only Trust and the Total Protection Trust, which applies to "revocable transfers." The settlor's retained power to change beneficiaries makes the designation of beneficiaries "revocable" within the meaning of section 2038, although the trust is irrevocable. If the assets of the Trust are included in the Grantor's estate, then the beneficiaries of the Trust receive a step up in basis under IRC §1014(b)(10), also a desired result.

2.6.6. Step Up in Basis.

2.6.6.1. Because the Living Trust Plus® is designed so that assets are included in the estate of the settlor, the trust beneficiaries will receive a step up in tax basis as to trust assets to the fair market value of the assets as of the settlor's death.[86]

2.6.7. Capital Gains Exclusion for Sale of Principal Residence.

2.6.7.1. If a taxpayer is considered the owner of the entire Trust (including the residence) under the Grantor Trust rules,[87] the taxpayer will be treated as the owner of the residence for purposes of satisfying the ownership requirements of section 121 of the Internal Revenue Code.[88]

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[85] IRC § 2036 and Treas. Reg. §20.2036-1

[86] See also IRC § 1014(b)(3), Treas. Reg. §§1.1014-2(a)(3), 1.1014-2(b).

[87] IRC §§ 671-679.

[88] See Rev. Rul. 85-45 (1985) and PLR 199912026 .

2.6.7.2. Accordingly, by transferring a residence to a Living Trust Plus® in which the settlor retains the right to income and/or retains a limited power of appointment, the section 121 exclusion from capital gains on the sale of a principal residence is maintained.[89]

2.7. TRUSTS FOR VETERAN'S ASSET PROTECTION PLANNING

2.8. Basic Overview of Veteran's Asset Protection Planning.

2.8.1. Purpose.

2.8.1.1. The Purpose of Veteran's Asset Protection Planning is to protect a wartime veteran's assets in order to qualify the veteran to receive the Veteran's Aid and Attendance special pension benefit to assist the Veteran in paying for long-term care, typically care delivered at home or in an assisted living facility. Of course, like Medicaid, the Veteran's Aid and Attendance special pension benefit has its own complex financial requirements that must be met.

2.8.1.2. Meeting the financial requirements is often a difficult hurdle for a veteran seeking aid and attendance benefits, and the use of an irrevocable trust can provide a helpful planning tool.

2.9. The Law.

2.9.1. United States Code.

2.9.1.1. Title 38 United States Code is the section that applies to veterans' benefits. Other sections of the United States Code have a bearing on VBA as well, such as Title 5 U.S.C. which concerns government organization and employees and Title 10 U.S.C. which pertains to the military.

2.9.1.2. The United States Code gives the Secretary of Veterans Affairs the authority to prescribe all rules and regulations which are necessary or appropriate to carry out the laws administered by the Department and are consistent with those laws. (Section 501, Title 38 U.S.C.)

2.9.2. Code of Federal Regulations

2.9.2.1. The Secretary's rules and regulations are contained in Title 38 of the Code of Federal Regulations (38 CFR.). The Compensation and Pension Service writes the regulations that pertain to the adjudication of claims for compensation, pension and other benefits that are processed by adjudication personnel. All regulations (proposed and final) are published in the Federal Register. One of the functions of

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[89] Begley, Jr. & Hook, *supra* at § 7.20[6][e].

the General Counsel is to give a written interpretation of the law whenever necessary.

2.9.3. Directives and Records

2.9.3.1. Directives provide instructions to VA personnel. There are different forms of directives but the ones most commonly encountered are Circulars (used when required for special projects, to implement a program with an ending date, to implement instructions subject to frequent change, or to test a procedure) and Manuals (designed to provide procedures for benefit payments and, in general, for all the work everyone in VA does).

2.9.3.2. The primary document used for Veterans Aid and Attendance is a Manual – specifically **M21-1: Adjudication Procedures.** See the VA website here for more information: http://www.benefits.va.gov/WARMS/Site_Map.asp.

2.9.4. Veterans Aid and Attendance - The New Rules

2.9.4.1. The Veterans Administration (VA) pays for long-term care primarily through its "Aid and Attendance" payments, which is actually a veteran's Special Pension with an add-on for Aid and Attendance. On January 23, 2015, proposed rule changes to amend the veterans pension application process were published by the VA in the Federal Register. These new rules went into effect October 18, 2018. The new rule changes have a significant effect on elder care planning for veterans, making asset protection trusts for veterans the primary planning tool, using the 3-year lookback period. The new rules mirror Medicaid rules in some ways, as they require a net worth determination and a look-back period, and impose penalties for asset transfers. Below is a brief summary of the key rules that went into effect on October 18, 2018:

2.9.4.2. **Net Worth.** The new rule imposes a net worth limit equal to the current maximum community spouse resource allowance for Medicaid purposes ($123,600). Net worth will be determined by combining assets and annual income. A veteran's assets are defined to include both the assets of the veteran and the assets of his or her spouse. A surviving spouse's assets would only include the assets of that surviving spouse.

2.9.4.3. **Calculation of Net Worth:**

2.9.4.3.1. All Countable Assets + (Annual Gross Income - net Unreimbursed Medical Expenses).

2.9.4.3.2. Countable Assets include assets of Veteran as well as the assets of the spouse.

2.9.4.3.3. See 38 CFR 3.275 for Criteria for Evaluating Net Worth.

2.9.4.4. **Look-back on Asset Transfers**

2.9.4.4.1. Under old VA rules, there was NO transfer penalty. This meant that your clients could transfer excess assets and apply for VA benefits the next day. New Reg. § 2.276(e) now imposes a look-back and transfer penalties. The new rules establish a three-year look-back period for asset transfers for less than fair market value; Medicaid has a five-year look back period. The penalty period will be calculated based on the total assets transferred during the look-back period to the extent they would have exceeded a new net worth limit that the rules also establish.

2.9.4.5. Exempt Assets - The Home?

2.9.4.5.1. Under the new rules, the primary residence along with a lot size up to 2 acres (regardless of value), is exempt. Under the old rules, a residence and underlying/surrounding land "similar in size to other residential lots in the vicinity" were not countable. If most residences in the area were on a 20 acres, the applicant's residence and surrounding land would not be countable.

2.9.4.5.2. The new rules impose a very worrisome 2 acre limit "unless the additional acreage is not marketable." The examples given with regard to nonmarketable acreage related to acreage "only slightly more than 2 acres," property that might be inaccessible (surrounded by other owners, perhaps) or property subject to zoning limits that could prevent a sale. It is unknown what other factors might make additional acreage "not marketable."

2.9.4.5.3. Example: Under the old rules, your client lives in his rural home on 12 acres of land, not uncommon for his county, where most people have lots of between 10 and 50 acres. Under the new rules, your client likely has 12 acres of countable real estate. Unless zoning laws or other "marketability issues" prohibit it, your client would most likely have to subdivide his property so that his lot is only 2 acres. This process, or course, could take several years, so it will, in almost all cases, be simpler to simply transfer the entire house and land into trust and wait out the 3-year lookback.

2.9.4.5.4. It is important to note that the house is not an exempt asset for Medicaid in Virginia, and in most states where it is "exempt" in connection with Medicaid, it is not truly protected because of Estate Recovery "clawback," so houses must still be protected (generally using in a Living Trust Plus™ Total Protection Trust) because anyone who is in need of Veterans Aid and Attendance will most likely, at some point in the future, be in need of Medicaid.

2.9.4.5.5. Once the primary residence is sold, the residence is no longer exempt because it has been converted to money, and that money will be countable as of

January 1 of the year following the year of sale. Another reason that houses need to be protected, preferably in a Living Trust Plus™ Total Protection Trust, prior to being sold.

2.9.4.5.6. Family transportation vehicles and personal items used on a regular basis.

2.9.4.5.6.1. Note: Multiple vehicles are excluded so long as they are used for the veteran on a regular basis; not so with Medicaid, which exempts only one vehicle.

2.9.4.5.7. Pre-paid burials and burial plots.

2.9.4.5.8. Any asset that was transferred or gifted prior to 10.18.18.

2.9.4.6. **Penalty Period**

2.9.4.6.1. Under the new regulations, veterans or their surviving spouse who transfer assets within three years of applying for benefits will be subject to a penalty period that can last up to 5 years.

2.9.4.6.2. There is a complex calculation to determine the penalty period. Rule 3.276(e)(1) uses a single divisor for all claimants, which results in equal penalty periods for equal amounts of precluded asset transfers regardless of the type of claimant. The single divisor is the MAPR in effect on the date of the pension claim at the aid and attendance level for a veteran with one dependent, currently $21,961 per year.

2.9.4.6.3. Only transfers of countable assets are penalized. Transfers of exempt (non-countable) assets are not penalized.

2.9.4.6.4. Transfers are only penalized if they adversely affect Net Worth (i.e., if the transfer reduces net worth to less than $123,600).

2.9.4.6.5. Transfers to set up a SNT for a dependent child who was disabled before the age of 18 are not penalized.

2.9.4.6.6. There are exceptions to the penalty period for fraudulent transfers and for transfers to a trust for a child who is unable to provide "self-support."

2.9.4.6.7. Under the new rules, the VA will determine a penalty period in months by dividing the amount transferred that would have put the applicant over the net worth limit by the maximum annual pension rate (MAPR) for a veteran with one dependent in need of aid and attendance. In 2018 that amount is approximately $2,170. Actually, the MAPR for a veteran qualifying for the maximum Aid & Attendance benefit with one dependent is $26,036 annually. The regulations say to divide that by 12 and drop the cents. Reg. § 3.276(e)(1). So technically in 2018 that amount is $2,169 ($26,036/12 = $2,169.67).

2.9.4.6.8. It does not matter at whether the transfer penalty is being calculated for a single veteran, a married veteran, or a widow of a veteran. Always use the MAPR for a veteran with a dependent divided by 12.

2.9.4.6.9. For example, assume the current net worth limit of $123,600 and an applicant has a net worth of $115,000. The applicant transferred $30,000 to a child during the look-back period.

2.9.4.6.9.1. If the applicant had not transferred the $30,000, his net worth would have been $145,000, which exceeds the net worth limit by $21,400. The penalty period will therefore be calculated based on $21,400, the amount the applicant transferred that put his assets over the net worth limit ($145,000-$123,600).

2.9.4.6.9.2. The transfer subject to penalty would be divided by the 2018 MAPR of $2,170, resulting in a 9.86 month penalty ($21,400 divided by $2,169 = 9.86). The penalty begins to run on the first day of the month following the month of transfer.

2.9.4.6.10. A penalized transfer may be cured in whole or partially, *provided that it is done within 60 days of the notice of penalty and evidence of cure is received by the VA no later than 90 days from the date of notice.*

2.9.4.7. **Annual Gross Income**

2.9.4.7.1. All income from sources such as wages, salaries, earnings, bonuses, income from business, profession, investments and rents (list not inclusive).

2.9.4.7.2. Income of spouse also included.

2.9.4.7.3. Waived income is also included in annual gross income computation.

2.9.4.7.4. Exception for withdrawing a SS application after finding of entitlement to SS benefits.

2.9.4.7.5. See 38 CFR 3.262 for how income is evaluated.

2.9.4.7.6. See 38 CFR 3.271 for computation of income.

2.9.4.7.7. See 38 CFR 3.272 for exclusions from income.

2.9.4.7.8. Shall be counted during the 12-month annualization period in which received.

2.9.4.8. **Unreimbursed Medical Expenses**

2.9.4.8.1. Any amounts paid within the 12-month annualization period regardless of when the indebtedness was incurred.

2.9.4.8.1.1. See 38 CFR 3.278 for definition of what constitutes a medical expense.

2.9.4.9. **Medical Expense Deductions from Income**

2.9.4.9.1. Medical expenses are those that are either medically necessary or improve a disabled individual's functioning. These medical expenses are deducted from income. This becomes more complicated when the claimant is receiving home care or is in an independent or assisted living facility, as the new rules somewhat limit the circumstances under which room and board expenses may be counted, as well as the amount paid. There are very specific rules as to which services qualify as medical expenses and the claimant will have to be able to identify those in his/her application. Section (d)(3)(i)(B) now provides, in final paragraph (d)(3)(iv), that payments for meals and lodging, as well as payments for other facility expenses not directly related to health or custodial care, are medical expenses when either of the following are true: (A) the facility provides or contracts for health care or custodial care for the disabled individual; or (B) a physician, physician assistant, certified nurse practitioner, or clinical nurse specialist states in writing that the individual must reside in the facility (or a similar facility) to separately contract with a third-party provider to receive health care or custodial care or to receive (paid or unpaid) health care or custodial care from family or friends.

2.9.4.9.2. The proposed limited the hourly amount that can be paid to a home health care provider and based the amount on a national average, rather than local costs for care. The final rule does not include a limit to the hourly rate of in-home care.

2.9.4.9.3. Any veterans trust established before the effective date of the new regulations will, hopefully, not be subject to the new rules.

2.9.5. Veterans Half-Loaf Asset Protection Planning Under the New Rules

2.9.5.1. The fact that the penalty period will begin the first day of the month that follows the last asset transfer makes this new law similar to the old Medicaid gifting rules that were in effect prior to the Deficit Reduction Act of 2005 ("DRA").

2.9.5.1.1. Under prior Medicaid law, someone already in a nursing home wanting to apply for Medicaid could give away half of his or her spend-down amount, immediately commencing the penalty period, and the nursing home resident would simply retain the other half to privately pay throughout the penalty period associated with the gift (as opposed to the Medicaid law since DRA, which says that the penalty period doesn't start until someone has applied for Medicaid and is otherwise eligible "but for" the penalty period). This old Medicaid gifting strategy will now be available in connection with applications for the Veterans Pension. Below is an example of how this strategy works.

2.9.5.1.2. Let's take John Jones, a single veteran. The net worth limit is $123,600. Mr. Jones has assets of $200,000 and annual income from Social Security of $24,000 ($2,000 per month) from Social Security. Adding his annual income to his assets produces a "net worth" of $224,000, which exceeds the net worth limit by $100,000, meaning that he has $100,400 in assets to be protected. Let's further assume that he lives in an Assisted Living Facility and his monthly cost of care is $6,000. Based on these assumptions, we can calculate his monthly shortfall as follows:

Assisted Living Facility Monthly Cost	$6,000
Minus Monthly Income	$2,000
Equals Monthly Assisted Living Shortfall	$4,000

Now that we know his monthly shortfall, we can calculate how much of his assets can be transferred to the applicant's children using the half-loaf strategy and how much must be retained and spent on Assisted Living Expenses to cover his monthly shortfall during the penalty period.

<table>
<tr><td>$4,000.00</td><td colspan="2">Monthly Assisted Living Shortfall</td><td rowspan="2">Penalty & Payout Period ▼</td></tr>
<tr><td>$100,400.00</td><td colspan="2">Assets to be protected</td></tr>
<tr><td>$31,000.00</td><td>⇦ Amount to be Transferred to Children</td><td>Number of Resulting Penalty Months, rounded down ⇨</td><td>17</td></tr>
<tr><td>$69,400.00</td><td>⇦ Amount to be Retained and Paid to ALF</td><td>Number of months that can be paid to ALF using the retained amount. ⇨</td><td>17</td></tr>
</table>

2.9.5.1.3. Result: After 17 months, $31,000 out of the $100,400 in unprotected funds has been protected, in addition to the $123,600 that Mr. Jones is allowed to keep, and Mr. Jones can now apply for Aid and Attendance and begin receiving his VA pension amount of $21,961 per year / $1,830 per month, all while keeping $154,600 out of the $200,000 he started with.

2.9.6. Filing a Veterans Pension Claim.

2.9.6.1. Complexity.

2.9.6.1.1. Filing a claim for the Veterans Pension Benefit is complex and time-consuming. If you want to do it correctly, it's important to get qualified assistance. Just knowing which form to fill out and how to complete it is a complex endeavor in itself. Even if the proper form is completed, failure to check a single box may result in a complete denial of your claim.

2.9.6.1.2. The application process involves: obtaining evidence of prospective, recurring medical expenses; appointments for VA powers of attorney and fiduciaries; and a thorough understanding of the application process. Often, qualification for this benefit involves reallocation of assets and shifting of income in order to qualify, and these reallocations may have significant impact on Medicaid eligibility.

2.9.6.1.3. Given that many veterans who need the Veterans Pension Benefit will most likely also need Medicaid in the future, this process should not be attempted without the help of an experienced elder law attorney who thoroughly understands both the Veterans Pension Benefit and the Medicaid program, as well as the interaction between these two benefit programs.

2.9.7. Using Trusts for Aid and Attendance.

2.9.7.1. Reducing Countable Assets.

2.9.7.1.1. It is a common planning practice for a veteran seeking to reduce countable assets to transfer assets to a properly-drafted irrevocable trust in a sufficient amount to reduce the veteran's assets at least 3 years before submitting an application for the Veteran's Aid and Attendance special pension benefit.

2.9.7.1.2. Not all irrevocable trusts, however, will allow the claimant to qualify for benefits. In fact, most irrevocable trusts do not work for Veteran's Asset Protection Planning.

2.9.7.1.3. Opinions from the VA counsel's offices make it clear that transfers of property to "special needs" trusts for the benefit of the veteran, particularly where the veteran is trustee, or other arrangements where the veteran retains any kind of "life estate" or "life interest" in the transferred property, will not result in the exclusion of the transferred property from the calculation of the veteran's net worth for purposes of the Aid and Attendance benefits.

2.9.7.1.4. As noted in a 1997 VA Office of General Counsel opinion[90]:

2.9.7.1.4.1. "[P]roperty and income from property may be countable as belonging to a claimant if the claimant possesses such control over the property that the claimant may direct that it be used for the claimant's benefit. Such control may be considered a sufficient ownership interest to bring the property within the scope of the pension laws. It follows that only property over which a claimant, or someone with legal authority to act on the claimant's behalf, has some control to use for the claimant's benefit can reasonably be expected to be consumed for a claimant's maintenance and thus be includable in the claimant's estate."

2.10. Trustee Considerations.

2.10.1. Can settlor Serve as Trustee for a Veterans Trust?

2.10.1.1. Although the settlor can absolutely act as trustee of the Living Trust Plus® for Medicaid purposes, many attorneys believe that the settlor should not act as the trustee of a trust designed for Veterans Asset Protection.

2.10.1.2. The VA's warning is that "[p]roperty and income from property may be countable as belonging to a claimant if the claimant possesses such control over the property that the claimant may direct that it be used for the claimant's benefit."

2.10.1.3. Accordingly, so long as the assets in the trust can not be used the for the claimant's benefit, there is no legal problem in having the claimant serve as trustee, unless the beneficiaries of the trust are residing in the Veteran's household, in which case the VA could attribute indirect benefit to the Veteran of distributions to the beneficiaries.

2.10.1.4. The ability of the claimant to serve as trustee is directly addressed by VAOPGCPREC 73-91, which presented the following two questions:

2.10.1.4.1. "Would proceeds from a life-insurance policy received by a veteran and shares of stock inherited by a veteran, which are placed into a valid irrevocable trust for the benefit of the veteran's grandchildren with the veteran as trustee, be counted as income of the veteran for purposes of determining entitlement to improved-pension benefits?

2.10.1.4.2. "Would these assets be considered in determining the veteran's net worth for improved-pension purposes?"

2.10.1.5. In answering these questions, the VA Office of General Counsel stated as follows:

[90] VAOPGCPREC 33-97, 1997, page 4, citing VAOPGCPREC 15-92 (1992) and VAOPGCPREC 72-90 (1990).

2.10.1.5.1. “We consider that principle legally sound on the basis that, as explained by the Assistant General Counsel in Undigested Opinion, 2-5-63 (Veteran), only property over which the veteran has some control to use for the veteran's own benefit can reasonably be expected to be consumed for the veteran's maintenance per 38 U.S.C. § 1522.

2.10.1.5.2. Under the circumstances described, the veteran in an individual capacity, as distinguished from a fiduciary capacity, would have no legal ownership of the property and no authority or right to use, control, or dispose of the property or the income therefrom for the veteran's own benefit after the proposed transfer. Under these circumstances, subject to the following discussion, the trust assets would not be considered a part of the veteran's estate. Further, income derived by the trust from trust assets would not be counted as income of the veteran for pension purposes. See O.G.C. Prec. 72-90.

2.10.1.6. In answering these questions, the VA Office of General Counsel held as follows:

2.10.1.6.1. “Generally, where a veteran places assets into a valid irrevocable trust for the benefit of the veteran's grandchildren, with the veteran named as trustee, and where the veteran, in an individual capacity, has retained no right or interest in the property or the income therefrom and cannot exert control over these assets for the veteran's own benefit, the trust assets would not be counted in determining the veteran's net worth for improved-pension purposes, and trust income would not be considered income of the veteran.

2.10.1.6.2. [However,] [i]f the beneficiaries of the trust are residing in the veteran's household and the veteran is receiving benefit from expenditures from the trust, a determination must be made under the facts of the particular case whether the veteran is exercising such control and use of the trust assets that the trust may be considered invalid for purposes of determining pension eligibility.

2.10.2. Can settlor Can Remove or Replace Trustee.

2.10.2.1. The same logic applies as above.

2.11. Taxation of the Total Protection Trust (Veterans Version).

2.11.1. Income Tax.

2.11.1.1. IRC § 678(a) states that "A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which: (1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself." The veterans version of the **Living Trust Plus® Total Protection Trust** allows the trust beneficiaries to demand all trust income each year, thus making the trust a grantor trust to the beneficiaries as to the income, which is the result we want because want all trust income to be taxable to the beneficiaries whether distributed to them or not.

2.11.1.2. This way, no income will be retained by the trust and reported to the grantor on an annual Grantor Trust Statement and no ordinary income from the trust will flow through to the Grantor's 1040. This could be important for some clients because the VA does something each year called an income verification match (IVM). If the trust income is reported on the Grantor's 1040, the VA might consider this to be the Grantor's income (which could affect the amount of the Aid and Attendance benefit the Veteran receives), even though the Grantor never actually receives the income.

2.11.1.3. The Settlor retains a testamentary power of appointment to distribute corpus, thereby allowing the assets remaining in Trust to be included as part of Settlor's gross taxable estate. The ability of the Settlor to change beneficiaries (i.e. who receives the trust corpus upon the Settlor's death) makes this a Grantor Trust as to the Settlor as to the trust corpus (IRC §674(a) and Treas. Regs. §1.674(d)-2(b)). Pursuant to IRC §674(a), "The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party." Estate inclusion is brought about by IRC section 2038, which applies to “revocable transfers.” The settlor’s retained power to change beneficiaries makes the designation of beneficiaries “revocable” within the meaning of section 2038, although the trust is irrevocable. If the assets of the Trust are included in the Grantor’s estate, then the beneficiaries of the Trust receive a step up in basis under IRC §1014(b)(10), also a desired result.

2.11.1.4. The Settlor of a Veterans Trust does not have the right to change beneficiaries during lifetime because that may be seen by the IRS as giving Settlor control over who receives the trust income, thus making this trust not a grantor trust as the beneficiaries, which could interfere with the ability to get Veteran's Aid and Attendance in the future because of trust income possibly being deemed to belong to the Settlor.

2.11.1.5. Pursuant to IRS Form 1041 Instructions, generally if a trust is treated as owned by two or more grantors or other persons, the trustee may choose Optional Method 3 as the trust's method of reporting instead of filing Form 1041. Optional Method 3 states that for a trust treated as owned by two or more grantors or other persons, the trustee must give all payers of income during the tax year the name, address, and TIN of the trust. The trustee also must file with the IRS the appropriate Forms 1099 to report the income or gross proceeds paid to the trust by all payers during the tax year attributable to the part of the trust treated as owned by each grantor, or other person, showing the trust as the payer and each grantor, or other person treated as owner of the trust, as the payee. The trustee must report each type of income in the aggregate and each item of gross proceeds separately.

2.11.2. Income Tax Reporting.

2.11.2.1. A separate taxpayer identification number is not required and a separate tax return (Form 1041) need not be filed by the trustee – just the appropriate 1099s for all trust income.

2.11.3. Gift Tax.

2.11.3.1. Because the Living Trust Plus® is designed so that the settlors retain a limited power of appointment in the trust corpus and can force the trustee to distribute corpus to beneficiaries at any time, transfers to the Living Trust Plus® are not considered completed gifts for gift tax purposes because a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves.[91]

2.11.4. Gift Tax Reporting.

2.11.4.1. Even though the transfer of assets into the trust is not considered a taxable gift, pursuant to Treas. Reg § 25.6019-3 a Form 709, U.S. Gift (and Generation Skipping Transfer) Tax Return should still be filed in the year of the initial transfer into the trust.[92] On the Form 709, the transaction should be shown on the return for the year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument(s) of transfer and a copy of the trust, should be submitted with the return.[93] The penalty for not filing a gift tax return is based on the amount of gift tax due, so if there is no amount due there should be no penalty for failure to file. Nevertheless, a gift tax return should be filed pursuant to Treas. Reg § 25.6019-3. Additionally, the filing of a gift tax return could provide additional evidence to future creditors, including Medicaid, that a completed transfer was in fact made despite the fact that the transfer was not considered by the IRS to be a completed gift for tax purposes.

2.11.4.2. Neither Treas. Reg § 25.6019-3 nor the IRS Form 709 Instructions reveal how to report an incomplete gift. However, Treas. Reg § 301.6501(c)-1(f)(2) provides in relevant part as follows:

"A transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift

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[91] Treas. Reg. § 25.2511-2(b).

[92] *See* Treas. Reg § 25.6019-3, which states that "[i]f a donor contends that his retained power over property renders the gift incomplete . . . and hence not subject to tax . . . , the transaction should be disclosed in the return for the . . . calendar year of the initial transfer and evidence showing all relevant facts, including a copy of the instrument of transfer, shall be submitted with the return. . . [along with] additional documents the donor may desire to submit."

[93] Treas. Reg § 25.6019-3.

and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed under this paragraph (f)(2) if the return (or a statement attached to the return) provides the following information—

(I) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and each transferee;

(iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument."

2.11.4.3. Although the transfer to the trust is an incomplete gift for gift tax purposes, if the trustee later distributes corpus from the trust to one or more of the beneficiaries, the tax result of such distribution is that a completed gift has now been made from the trust settlor to the beneficiary. Accordingly, a gift tax return should be filed by the settlor for the tax year of such distribution if the amount of such distribution exceeds the annual exemption amount.

2.11.5. Estate Tax.

2.11.5.1. Because the Living Trust Plus® Veterans Version is designed so that the settlors retain a limited testamentary power of appointment over the trust corpus, transfers to this Living Trust Plus® are included as part of Settlor's gross taxable estate pursuant to Internal Revenue Code Section 2038.

2.11.5.2. Section 2038 states in relevant part that the "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 . . . by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power . . . ."

2.11.6. Step Up in Basis.

2.11.6.1. Because the Living Trust Plus® is designed so that assets are included in the estate of the settlor, the trust beneficiaries will receive a step up in tax basis as to trust assets to the fair market value of the assets as of the settlor's death.[94]

2.11.7. Capital Gains Exclusion for Sale of Principal Residence.

2.11.7.1. If the Grantor is considered the owner of the entire Trust (including the residence)

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[94] See also IRC § 1014(b)(3), Treas. Reg. §§1.1014-2(a)(3), 1.1014-2(b).

under the Grantor Trust rules,[95] the taxpayer will be treated as the owner of the residence for purposes of satisfying the ownership requirements of § 121 of the Internal Revenue Code.[96]

2.11.7.2. Accordingly, by transferring a residence to the Living Trust Plus® "Residence Trust," one where the Settlor retains Grantor Trust powers over the entire trust – both income and principal – because the settlor retains the right to receive income and/or a limited lifetime and testamentary power of appointment, the exclusion from capital gains on the sale of a principal residence is maintained.

2.12. Comparison of the Living Trust Plus® with Offshore & Domestic APTs.

2.12.1. Source of Confusion.

2.12.1.1. The plain meaning of the term "self-settled trust" is a trust established by a settlors for his own benefit. Such plain meaning would obviously include a long list of various types of trusts, including revocable trusts and all types of irrevocable trusts from which the settlors can derive any benefit.

2.12.1.2. Unfortunately, the term "self-settled trust" is a widely misused term that has created a great deal of confusion in the legal profession. In almost all legal treatises, articles, and reported cases, the term "self-settled trust" is used not in the sense of its plain meaning, but rather as a "term of art" – specifically describing an irrevocable trust where the settlor's goal is asset protection yet the settlor is also a beneficiary as to both income and principal.

2.12.1.2.1. Under traditional trust law, this type of "self-settled trust"[97] has never been effective for asset protection purposes because, as explained in detail in section 2.5, if a settlor has the right to receive distributions of principal from the trust, then so do his creditors, because a creditor of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit.

2.12.1.2.2. Under current law, this type of "self-settled trust" is absolutely ineffective for Medicaid asset protection purposes because, as explained in detail in section 2.2.5, if either spouse has access to principal, the assets in the trust will be deemed "countable" for Medicaid eligibility purposes.

2.12.2. Clearing Up the Confusion About "Self-Settled" Trusts.

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[95] IRC §§ 671-679.

[96] See Rev. Rul. 85-45 (1985) and PLR 199912026 .

[97] For uniformity with other commentators, the term "self-settled trust" will (reluctantly) be used herein to refer specifically to a self-settled trust intended to protect the settlor's assets while allowing the settlor to receive distributions of principal directly from the trust corpus, unless stated otherwise.

2.12.2.1. What has confused many practitioners is that most authors of articles and treatises on asset protection trusts, and many judges in reported decisions, use the term "self-settled trust" indiscriminately, without explaining that they are using it as a term of art, intending to refer to a very specific type of "self-settled trust," *i.e.*, an irrevocable trust where the settlor is allowed to receive distributions of both income and principal.

2.12.2.1.1. The Living Trust Plus® is certainly a "self-settled trust" within the plain meaning of the term, but it is not a "self-settled trust" as that term is currently used in the legal profession because it does not allow the settlors the right to receive distributions of principal, but rather only distributions of income and the right to use any trust-owned real estate.

2.12.2.1.1.1. The Living Trust Plus® allows complete protection of the settlor's assets as explained in section 2.5 because the settlors does not retain any right to the return of corpus. A standard Living Trust Plus® does not protect the income generated by the trust assets, but it does protect the underlying assets, which is what most clients care about most, and is what "asset" protection is all about.

2.12.2.1.1.2. The Living Trust Plus® Income Protection Trust, also called the Veterans Trust Plus™, protects the assets and the income, because the settlor of the trust is not allowed to receive either income or principal from the trust.

2.13. Fraudulent Transfers.

2.13.1. Applicability.

2.13.1.1. No asset protection trust (or any other asset protection entity) is designed to protect assets that have been fraudulent transferred.

2.13.1.2. Funding of a Living Trust Plus® should only occur while a client is essentially free from financial difficulties.

2.13.2. UFTA.

2.13.2.1. Most U.S. jurisdictions follow the 1984 Uniform Fraudulent Transfer Act ("UFTA"), which allows creditors to set aside a fraudulent transfer and enforce the judgment against the assets as if the fraudulent transfer never took place.[98]

2.13.2.1.1. With respect to present creditors, Section 5(a) of the UFTA provides that: "[a] transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the debtor made the transfer and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer."

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[98] Shaftel and Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, *supra*.

2.13.2.1.2. With respect to present and future creditors, Section 4(a) of the UFTA provides:

"A transfer made by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made, if the debtor made the transfer:

(1) with actual intent to hinder, delay or defraud any creditor or the debtor, or

(2) without receiving a reasonably equivalent value in exchange for the transfer and:

(a) the debtor intended to incur, or believed or reasonably should have believed that he/she would incur debts beyond his/her ability to pay as they became due; or

(b) the debtor was engaged or was about to engage in business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction.

2.13.2.1.3. UFTA has a four-year statute of limitations but contains a one-year discovery exception to that limitations period, meaning that if a creditor reasonably discovers a transfer to a Living Trust Plus® after the four-year limitations period has expired, the creditor has an additional year in which to file an action and argue that the transfer to the IOT was made with the intent to hinder, delay, or defraud the creditor.

2.13.3. BAPCPA.

2.13.3.1. On 4/20/05, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The key operative language of the relevant amendment (11 U.S.C. §548(e)) to the 2005 Bankruptcy Act states that the bankruptcy trustee:

"may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if--
(A) such transfer was made to a self-settled trust or similar device;
(B) such transfer was by the debtor;
© the debtor is a beneficiary of such trust or similar device; and
(D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted."[99]

[99] 11 USC § 548(e)(1).

2.13.3.1.1. The operative language in subsection D is identical to the existing fraudulent transfer language of Bankruptcy Code section 548(a)(1)(A), with the two-year limitations period extended to ten years. Similarly, the operative language "actual intent to hinder, delay, or defraud" is identical to the language used in the Uniform Fraudulent Transfer Act ("UFTA").[100]

2.13.3.1.2. Accordingly, the result of the 2005 Bankruptcy Act is that Congress extended the section 548 fraudulent transfer remedy, duplicating a remedy that already existed in the 42 states that have adopted UFTA, the only significant difference being a fixed ten-year limitations period instead of four years plus a one-year discovery period.[101]

2.13.3.1.3. The consequence of this amendment is that it now provides a uniform fraudulent transfer remedy in all 50 states. However, because the IOT is not intended to allow fraudulent transfers, the 2005 Bankruptcy Act does not change the effectiveness of a Living Trust Plus® that is properly used for asset protection, *i.e.,* established and funded while a client is essentially free from financial difficulties.[102]

2.13.4. Fraudulent Transfers as to Future Creditors.

2.13.4.1. Transfers to IOTs made "with actual intent to hinder, delay, or defraud any entity to which the debtor was *or became, on or after the date that such transfer was made, indebted*" (emphasis added) are voidable under new Bankruptcy Code § 548(e). The prior version of Bankruptcy Code § 548 contained the same language. The parallel UFTA provision applies "whether the creditor's claim arose before or after the transfer." UFTA § 4(a).

2.13.4.2. Although this definition appears to encompass virtually any creditor, case law has narrowly defined "future creditor."[103] The general rule under UFTA is that transfers motivated out of mere caution, as opposed to fraudulent intent, and made at a time when one does not have creditors, generally do not constitute fraudulent transfers.[104] In fact, for purposes of the fraudulent transfer laws, the term "future creditor" may be a misnomer, because it generally means a creditor who presently

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[100] Shaftel and Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, *supra*.

[101] Shaftel and Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, *supra*.

[102] Shaftel and Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, *supra*.

[103] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 3.03[4][a], *citing Stratton v. Edwards*, 174 Mass. 374, 378, 54 NE 886, (1899); *Williams v. Banks*, 11 Md. 198, 227 (1857); *Winchester v. Charter*, 94 Mass. (12 Allen) 606, 609–611 (1866).

[104] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 6.09[1].

holds contingent, unliquidated, or unmatured claims, all of which are included in the definition of the term “claim” under the various fraudulent transfer laws.[105]

2.13.4.3. In order for a transfer to be made with the requisite fraudulent intent directed toward a specific future creditor, such intent must be contemporaneous with the transfer, or there must be some other connection between the two elements so that it can be said that the transfer was intended to injure that specific future creditor.[106]

2.13.4.4. Under the weight of authority, transfers made to avoid”unknown future creditors” are not avoidable under the UFTA; however, there are some contrary cases that appear to be aberrational.[107]

2.13.4.5. One important question is whether the Bankruptcy Code provisions (including the 2005 Bankruptcy Act provisions) will be interpreted in the same way as the UFTA provisions; that is, will a transfer made out of mere caution be avoidable as a fraudulent transfer? The Bankruptcy Code and the UFTA are read by reference to each other (i.e., *in pari materia*). Using this rule of interpretation, it would appear that the 2005 Bankruptcy Act's fraudulent transfer provisions would be interpreted in a way that would not prohibit transfers made with respect to unknown creditors (i.e., transfer motivated by mere caution). But a contrary interpretation is possible. The Bankruptcy Code provisions, although similar to the UFTA provision, is not identical, and the policy concerns are different so the result might be different. In any event these musings are clearly speculative and the matter will ultimately be subject to the vicissitudes of future judicial proceedings.[108]

2.13.5. Is Medicaid a Creditor?

2.13.5.1. An interesting question in the context of using IOTs for Medicaid asset protection is whether Medicaid is considered a “creditor” under fraudulent transfer laws. Whether Medicaid is or is not a creditor is determined by State law, as Federal law is silent on the issue.[109]

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[105] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 3.03[4][a].

[106] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 3.03[4][a], *citing* G. Glenn, Fraudulent Conveyances and Preferences § 319, at 557 (rev. ed. 1940).

[107] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 6.09[1].

[108] Spero, *Asset Protection: Legal Planning, Strategies and Forms* at ¶ 6.09[1].

[109] *See* Whitenack, Mazart, and Spielberg, *The Revival of the Income-Only Trust in Medicaid Planning*, *supra*., p. 37, stating that in some states Medicaid is not considered a creditor, and *citing Matter of Tomeck*, 872 NE2d 236 (2007), for the finding that a transfer of the marital home to an income-only trust does not violate debtor/creditor law.

2.13.5.2. To some extent, the question of whether Medicaid is considered a creditor under the Bankruptcy Code and UFTA is moot because of the application of the Medicaid 5-year lookback period[110] which effectively takes the place of the fraudulent transfer rules in the context of Medicaid.

2.13.5.3. Nevertheless, there are two types of transfers that could be looked at in connection with this inquiry – the initial transfer by a settlors into a Living Trust Plus® and any subsequent transfer by a Trustee of a Living Trust Plus® to beneficiaries other than the settlors.

2.13.5.4. Transfers by a settlors into a Living Trust Plus® established for estate planning and asset protection purposes while a client is relatively healthy and essentially free from financial difficulties, made without actual or constructive fraudulent intent, should clearly protect the assets from future creditors of the settlors, including Medicaid (if Medicaid is considered a creditor under the prevailing State law).

2.13.5.5. Once assets have been transferred into a Living Trust Plus®, they are no longer legally owned by the settlors; thus any future distribution from the Living Trust Plus® is not a transfer by the settlors, and therefore logically can not be considered a fraudulent transfer by the settlors.

2.13.5.6. Logically, a distribution from a Living Trust Plus® can only give rise to a fraudulent transfer claim if the creditor has a claim against the Living Trust Plus® itself, *i.e.*, against trustee of the Living Trust Plus® in his representative capacity as trustee. Does the trustee of a Living Trust Plus® engage in a fraudulent transfer by distributing trust principal to beneficiaries other than the settlors (or reallocating trust investments to reduce income) prior to filing for Medicaid, knowing that this will result in a loss of income by the settlors and therefore less income available to contribute to Medicaid? The answer to this question ought to be no because, prior to filing, Medicaid is never a creditor of the Living Trust Plus®. Medicaid may be a creditor (or future creditor) of the settlors, and the settlors may be a creditor of the Living Trust Plus® (based on the settlor's right to receive income from the Living Trust Plus®), but this does not make Medicaid a creditor of the Living Trust Plus® unless and until the settlor assigns his income interest in the Living Trust Plus® to Medicaid, which would never happen prior to filing for Medicaid.

SECTION 3. THE TEN MOST COMMON MEDICAID MYTHS.

3.1. Myth 1: "Greedy children want Medicaid Planning to protect their inheritance."

3.1.1. Reality:

[110] *See supra* section 2.2.1.2.

3.1.1.1. If I get the feeling that a child has unduly influenced his or her parent to come visit me in order to preserve an inheritance, I will send them packing. Most Elder Law attorneys have a passion for protecting the dignity and quality of life of the Elder, which is what Elder Law is all about.

3.1.2. Reality:

3.1.2.1. The expenses of long-term care caused by a chronic illness are often catastrophic because in the United States, citizens do not have a right to basic long-term care. Through Medicare, seniors have had virtually universal health insurance coverage for most chronic illnesses since 1965. For individuals under age 65, private health insurance has likewise always covered treatment, medication, and surgery for most chronic illnesses - such as heart disease, lung disease, kidney disease, and hundreds of other chronic medical conditions.

3.1.3. Reality:

3.1.3.1. Our American health insurance system essentially discriminates against people suffering from certain types of chronic illnesses, i.e., chronic illnesses that routinely result in the need for long-term care, such as: Alzheimer's disease and other types of dementias; Parkinson's disease and other types of degenerative disorders of the central nervous system; Huntington's disease, Amytrophic Lateral Sclerosis (ALS), and other progressive neurodegenerative disorders; and many genetic disorders such as Multiple Sclerosis, Muscular Dystrophy, and Cystic Fibrosis. So those Americans suffering the misfortune of one of these diseases must also suffer the misfortune of having the "wrong" disease according to our American health insurance system. Is it an ethical social policy that seemingly arbitrarily distinguishes among these different types of illnesses? Is it an ethical social policy that provides full coverage for most illnesses - whether chronic or acute - but forces Americans with certain chronic conditions (many of them elders) to become impoverished in order to gain access to the long-term care necessitated by their particular type of chronic illness? Is it a surprise that clients suffering the "wrong type" of chronic illness will want to look for legal ways to preserve the efforts of their lifetime in order to protect themselves from this unfair and arbitrary social policy?

3.1.4. Reality:

3.1.4.1. Medicaid asset protection planning is not about "cheating" or "gaming" the system; it is about understanding and using existing laws that enable us to help our clients preserve their dignity and self-worth and avoid being financially destroyed by our unfair health care system.

3.2. Myth 2: "A nursing home resident must 'spend down' virtually all assets on nursing home care before qualifying for Medicaid."

3.2.1. Reality:

3.2.1.1. Elder Law Attorneys who specialize in Medicaid Asset Protection legally help nursing home residents protect significant assets every day. For a married client, we can generally protect 100% of their assets, regardless of how the assets are titled, without forcing them to get divorced. For an unmarried client, we can generally protect 40% to 70% of the assets.

3.3. Myth 3: "It is illegal to transfer assets in the 5 years prior to applying for Medicaid."

3.3.1. Reality:

3.3.1.1. Nothing is illegal about transferring your own assets, though there may be Medicaid consequences in doing so. Many legal and ethical asset protection strategies do involve transferring assets.

3.4. Myth 4: "Once someone is in a nursing home, it's too late to do any asset protection."

3.4.1. Reality:

3.4.1.1. It's never too late to protect assets, even if you or a loved one is already in a nursing home facility.

3.5. Myth 5: "Someone on Medicaid gets lower quality care than someone paying privately."

3.5.1. Reality:

3.5.1.1. Disparate treatment between Medicaid recipients and private pay residents is illegal. In fact, Medicaid recipients who have worked with a qualified Elder Law Attorney often get much better care than their private-pay counterparts because the money that has been protected is often used by a loving family member to help the elder obtain better quality care and to maintain dignity and quality of life.

3.6. Myth 6: "Medicare will pay for long-term care in a nursing home."

3.6.1. Reality:

3.6.1.1. Medicare only pays for short-term rehabilitation, and only for a limited time and under limited circumstances. Medicare does not pay a single penny for long-term care.

3.7. Myth 7: "All Power of Attorney documents are basically the same."

3.7.1. Reality:

3.7.1.1. Full gifting powers must be in a Power of Attorney in order to facilitate Medicaid Asset Protection planning. If you're an Estate Planning attorney or General Practitioner who routinely limits gifting in your POAs, you need to reconsider this practice, which ultimately does a tremendous disservice to your clients.

3.8. Myth 8: "A revocable living trust will protect assets from Medicaid."

3.8.1. Reality:

3.8.1.1. A regular living trust does not protect assets from Medicaid. For a detailed explanation of a living trust that does protect assets from Medicaid, while allowing the Settlor the ability to act as trustee and change beneficiaries, see the http://www.livingtrustplus.com.

3.9. Myth 9: "An irrevocable trust can never be changed or terminated."

3.9.1. Reality:

3.9.1.1. An "irrevocable" trust is a trust that cannot be revoked by the settlor unilaterally. Modification and/or termination can occur by consent between all interested parties.

3.10. Myth 10: "A Client with over $1 million won't ever need Medicaid."

3.10.1. Reality:

3.10.1.1. Nursing homes nationally now average more than $100,000 per year. A million dollars doesn't go as far as it used to. I've had clients that have spent over $1 million on nursing home care before coming to see me. Long-term Care Medicaid is not a program for poor people with low income; it's an entitlement program for people who are able to legally qualify under the provisions of applicable laws, regulations, and policy.

SECTION 4. THE MORALITY OF MEDICAID PLANNING

4.1. "Hide" is a 4-Letter Word

4.1.1. Elder Law attorneys do not hide assets.

4.1.1.1. Hide is literally a 4-letter word, and has no place in an Elder Law practice. Elder Law attorneys legally "protect" or "shelter" assets using the applicable laws that are available. Medicaid Asset Protection is absolutely ethical and moral; in fact, it is the "right" thing to do if a family is concerned about the long-term care of a loved one. From a moral and ethical standpoint, Medicaid planning is no different from income tax planning and estate planning.

4.2. Medicaid Planning is Just Like Income Tax Planning

4.2.1. What is Income Tax Planning?

4.2.1.1. Income tax planning involves trying to find all of the proper and legal deductions, credits, and other tax savings that you are entitled to - taking maximum advantage of existing laws. Income tax planning also involves investing in tax-free bonds, retirement plans, or other tax-favored investment vehicles, all in an effort to minimize what you pay in income taxes and maximize the amount of money that remains in your control to be used to benefit you and your family.

4.3. Medicaid Planning is Just Like Estate Tax Planning

4.3.1. What is Estate Planning?

4.3.1.1. Estate planning involves trying to plan your estate to minimize the amount of estate taxes and probate taxes that your estate will have to pay to the government, again taking maximum advantage of the existing laws. Similar to income-tax planning, estate planning is a way to minimize what your estate pays in taxes and maximize the amount of money that remains in your estate to be used to benefit your family.

4.3.1.2. Similarly, Medicaid planning involves trying to find the best methods to transfer, shelter, and protect your assets in ways that take maximum advantage of existing laws, all in an effort to minimize what you pay and maximize the amount of money that remains in your control to be used to benefit you and your family.

4.3.1.3. Like income-tax planning and estate planning, Medicaid planning requires a great deal of extremely complex knowledge due in part to constantly-changing laws, so clients need to work with experienced Elder Law attorneys who know the rules and can give proper advice.

4.4. Medicaid Planning is Just Like Long-Term Care Insurance.

4.4.1. What is Long-Term Care Insurance?

4.4.1.1. For seniors over the age of 65, Medicaid has become equivalent to federally-subsidized long-term care insurance, just as Medicare is equivalent to federally-subsidized health insurance. Congress accepts the realities of Medicaid Planning through rules that protect spouses of nursing home residents, allow Medicaid Asset Protection via the purchase of qualified Long-Term Care Insurance policies, allow the exemption of certain types of assets, and permit individuals to qualify even after transferring assets to a spouse or to a disabled family members or to a caregiver child. To plan ahead and accelerate qualification for Medicaid is no different than planning to maximize your income tax deductions to receive the largest income tax refund allowable. It's no different than taking advantage of tax-free municipal bonds. It's no different than planning your estate to avoid paying estate taxes.

4.5. Medicaid Planning to Overcome Discriminatory Health Insurance System

4.5.1. How America's Health Insurance System Discriminates.

4.5.1.1. One of the inherent tragedies of our American health insurance system is that it discriminates against people suffering from certain types of chronic illnesses, i.e., those that routinely result in the need for long-term care, such as Alzheimer's disease and other types of dementias; Parkinson's disease and other types of degenerative disorders of the central nervous system; Huntington's disease, Amytrophic Lateral Sclerosis (ALS), and other progressive neurodegenerative disorders; and many genetic disorders such as Multiple Sclerosis and Muscular Dystrophy. Those Americans suffering the tragedy of one of these diseases must also suffer the tragedy of having the "wrong" disease according to our American health insurance system.

4.5.1.2. Why should someone with brain cancer – tumors in the brain that aren't supposed to be there – have all of his treatment (chemotherapy, radiation, and surgery) covered by health insurance, yet someone with Alzheimer's – plaques and tangles in the brain that aren't supposed to be there – must pay for his care out of pocket until he goes broke. In both cases, we are dealing with the care that someone needs because of the disease that person has. How is the differing result fair? It's not.

4.5.1.3. Is it an ethical social policy that seemingly arbitrarily distinguishes among these different types of illnesses? Is it an ethical social policy that provides full coverage for most illnesses - whether chronic or acute - but forces Americans with certain chronic conditions (many of them elders) to become impoverished in order to gain access to the long-term care necessitated by their particular type of chronic illness? Is it a surprise that Americans suffering the "wrong type" of chronic illness will want to look for legal ways to preserve the efforts of their lifetime in order to protect themselves from this unfair and seemingly arbitrary social policy?

SECTION 5. THE ETHICS OF MEDICAID PLANNING

5.1. Identifying the Client

5.1.1. Who is the Client?

5.1.1.1. Although family involvement may be very important in some elder law matters, above all, elder law attorneys seek to promote the dignity, self-determination, and quality of life of the elders we serve. Who is our client? Almost always the elder for whom we are doing work and drafting documents. The client is the person whose interests are most at stake in the legal planning or legal problem. The client is the one—the only one —to whom the lawyer has professional duties of competence, diligence, loyalty, and confidentiality. This is especially important in elder law, because family members may be very involved in the legal concerns of the older person, and may even have a stake in the outcome. It is possible, in some circumstances, for more than one family member to be clients of the same lawyer. This is common with married couples. However, in most of our cases, we will identify the elder or disabled person as our client. We will do this, of course, regardless of who is paying the bill.

5.2. Conflicts of Interest

5.2.1. Eliminating Conflicts of Interest when Someone Else Pays Your Client's Fee.

5.2.1.1. Occasionally a child or children of the parent or parents you are representing pay your fee. Anytime this happens, you need to make it clear in your verbal discussions and in your written Fee Agreement that regardless of who pays your fee, the elders are your clients, and that having someone else pay your fee will not interfere with your independence of professional judgment or with the client-lawyer relationship.

5.2.1.2. **ABA Model Rules of Professional Conduct Rule 1.8(f)** says that "A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

5.2.1.3. Suggested language to include in your written Fee Agreement with your client: "You are our Client regardless of whether you, or someone else on your behalf, pays our fee."

5.3. Dealing with Diminished Capacity

5.3.1. Handling Clients With Diminished Capacity

5.3.1.1. When dealing with elder law matters, it is very common to be dealing with a client who has diminished capacity. **ABA Model Rules of Professional Conduct Rule 1.14** addresses dealing with the **Client With Diminished Capacity**. It says:

"(a) When a client's capacity to make adequately considered decisions in connection with a representation is diminished, whether because of minority, mental impairment or for some other reason, the lawyer shall, as far as reasonably possible, maintain a normal client-lawyer relationship with the client.

"(b) When the lawyer reasonably believes that the client has diminished capacity, is at risk of substantial physical, financial or other harm unless action is taken and cannot adequately act in the client's own interest, the lawyer may take reasonably necessary protective action, including consulting with individuals or entities that have the ability to take action to protect the client and, in appropriate cases, seeking the appointment of a guardian ad litem, conservator or guardian.

"(c) Information relating to the representation of a client with diminished capacity is protected by Rule 1.6. When taking protective action pursuant to paragraph (b), the lawyer is impliedly authorized under Rule 1.6(a) to reveal information about the client, but only to the extent reasonably necessary to protect the client's interests."

5.3.2. The relevant Comments to this rule state as follows:

"[3] The client may wish to have family members or other persons participate in discussions with the lawyer. When necessary to assist in the representation, the presence of such persons generally does not affect the applicability of the attorney-client evidentiary privilege. Nevertheless, the lawyer must keep the client's interests foremost and, except for protective action authorized under paragraph (b), must look to the client, and not family members, to make decisions on the client's behalf.

5.3.3. Meeting with Client and Family Member.

5.3.3.1. Thus, it is acceptable under Rule 1.14 to meet with both the client and the client's family members so long the presence of such family members (normally adult children of the client) does not affect the applicability of the attorney-client evidentiary privilege.

5.3.4. Another relevant Comment to Rule 1.14 states as follows:

"[4] If a legal representative has already been appointed for the client, the lawyer should ordinarily look to the representative for decisions on behalf of the client."

5.3.4.1. This means that if the client already has signed a comprehensive General Power of Attorney, then the elder law attorney may look to the Agent under that Power of Attorney for decisions on behalf of the client.

5.3.4.2. If the client has not yet signed a comprehensive General Power of Attorney, then the elder law attorney should consider whether the client is competent enough to sign, and desires to sign, a comprehensive General Power of Attorney allowing a loved one named by the client to make future legal decisions on behalf of the client.

5.3.5. Taking Protective Action

5.3.5.1. Another relevant Comment to Rule 1.14 states as follows:

[5] If a lawyer reasonably believes that a client is at risk of substantial physical, financial or other harm unless action is taken, and that a normal client-lawyer relationship cannot be maintained as provided in paragraph (a) because the client lacks sufficient capacity to communicate or to make adequately considered decisions in connection with the representation, then paragraph (b) permits the lawyer to take protective measures deemed necessary. *Such measures could include: consulting with family members,* using a reconsideration period to permit clarification or improvement of circumstances, *using voluntary surrogate decisionmaking tools such as durable powers of attorney* or consulting with support groups, professional services, adult-protective agencies or other individuals or entities that have the ability to protect the client. *In taking any protective action, the lawyer should be guided by such factors as the wishes and values of the client to the extent known, the client's best interests and the goals of intruding into the client's decision making autonomy to the least extent feasible, maximizing client capacities and respecting the client's family and social connections.*

"[6] In determining the extent of the client's diminished capacity, the lawyer should consider and balance such factors as: the client's ability to articulate reasoning leading to a decision, variability of state of mind and ability to appreciate consequences of a decision; the substantive fairness of a decision; and the consistency of a decision with the known long-term commitments and values of the client. In appropriate circumstances, the lawyer may seek guidance from an appropriate diagnostician.

"[7] If a legal representative has not been appointed, the lawyer should consider whether appointment of a guardian ad litem, conservator or guardian is necessary to protect the client's interests. Thus, if a client with diminished capacity has substantial property that should be sold for the client's benefit, effective completion of the transaction may require appointment of a legal representative. . . .*In many circumstances, however, appointment of a legal representative may be more expensive or traumatic for the client than circumstances in fact require.* Evaluation of such circumstances is a matter entrusted to the professional judgment of the lawyer. *In considering alternatives, however, the lawyer should be aware of any law that requires the lawyer to advocate the least restrictive action on behalf of the client.*" (emphasis added)

5.3.6. Using the Least Restrictive Action.

5.3.6.1. The Comments above make clear that it is desirable when possible to use voluntary surrogate decision making tools such as durable powers of attorney, which are much less expensive and much less traumatic than forcing the client to go through the financial and personal hardship of a guardianship and conservatorship hearing.

5.4. Eliminating Conflicts of Interest

5.4.1. Current Clients

5.4.1.1. ABA Model Rules of Professional Conduct Rule *1.7 Conflict Of Interest: Current Clients* says:

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

5.4.2. Eliminating Conflicts of Interest When Representing Married Couples

5.4.2.1. Elder law attorneys, like all attorneys, have an ethical obligation to avoid conflicts of interest. This means that, in most situations, a lawyer may only represent one individual or a married couple with aligned interests. For example, when legal planning involves multi-generational property such as a family home in which several people have an interest, these interests are almost always actually or potentially conflicting. Sometimes joint representation is possible under ABA Model Rules of Professional Conduct Rule 1.7, even with potential conflicts of interest, but it is more likely that we will be representing only the older person or married couple whose interests are at stake. This is especially true when the older person wants to discuss a power of attorney, a will or trust, or planning for long-term care.

5.4.2.2. It is common for a husband and wife to employ the same lawyer or law firm to assist them in Medicaid Planning and/or Estate Planning. Comment 27 to Rule 1.7

states: “For example, conflict questions may arise in estate planning and estate administration. A lawyer may be called upon to prepare wills for several family members, such as husband and wife, and, depending upon the circumstances, a conflict of interest may be present . . . In order to comply with conflict of interest rules, the lawyer should make clear the lawyer's relationship to the parties involved.” Sometimes this conflict can be avoided by representing just one spouse. But oftentimes it is essential to represent both spouses because you are preparing documents and performing services for both spouses.

5.4.2.3. When we represent a married couple, we include the following language in our Retainer Agreement as a way to comply with Rule 1.7 and eliminate any potential conflict of interest: “You have asked us to represent both of you in this planning, on a joint basis. It is important that you understand that, because we will be representing both of you, both of you will be considered our clients. Accordingly, matters that one Spouse might discuss with us must be disclosed to the other Spouse. Ethical considerations prohibit us from agreeing that either Spouse may withhold information from the other. In this regard, we will not give legal advice to either Spouse or make any changes to the Plan without mutual knowledge and consent from both Spouses. Of course, anything either Spouse discusses with us is privileged from disclosure to third parties except as otherwise indicated in this Legal Services Agreement. If and when one Spouse enters a nursing home, Medicaid laws and regulations currently offer certain protections to the Spouse remaining at home ("At-Home Spouse"). We understand that it is your desire to take full advantage of whatever techniques are available to protect the At-Home Spouse, if applicable. If either of you has children by a prior marriage, it is understood that some of these techniques may work to the disadvantage of those children. Nevertheless, you have instructed us to fully protect the At-Home Spouse, even at the expense of the children of a prior marriage, though we will always encourage the protection of any children of a prior marriage. By executing this Legal Services Agreement, you indicate your consent to having us represent both of you. Any communications and information will be fully disclosed by us to both of you. We have explained to you the possibility of conflict that is raised by such multiple representation. Specifically, potential conflicts in this case include, but are not limited to, the following: how property should be titled; how property should be disposed of upon death; what persons should serve in fiduciary capacities (e.g., executors, trustees, guardians); and the possibility that an uncontested divorce proceeding between the two of you may be the best strategy to protect assets and secure Medicaid eligibility. Each of you may have different interests, goals, or perspectives regarding these or other matters. Each of you expressly consents to joint representation despite the possibility of conflict; however, we may withdraw from representing one or both of you if there is an actual conflict between your interests. If it is decided that an uncontested divorce proceeding is the best strategy to protect assets and secure Medicaid eligibility, then you both agree that the firm may represent the Medicaid applicant and help secure separate counsel for the non-applicant spouse, in which event the firm's ongoing representation of the non-applicant spouse will be deemed to be automatically terminated at such time."

SECTION 6. PRACTICE TOOLS.

6.1. Evan Farr's Living Trust Plus® Asset Protection System.

6.1.1. http://www.LivingTrustPlus.com

6.2. Elder Counsel Elderdocx

6.2.1. http://www.eldercounsel.com/elderdocx/

6.3. Interactive Legal Elder Law Planing.

6.3.1. https://interactivelegal.com/Elder-Law-Planning.php