ELDERCOUNSELOR
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The Value of Using Irrevocable Trusts in Medicaid Planning

Irrevocable trusts are a valuable tool in Medicaid and long term care planning. However, outright gifting of assets is also an option. This issue of Elder Counselor discusses the advantages of the irrevocable trust.

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Outright gifts are simple to do with costs often being limited to expenses such as preparing and recording deeds and gift tax returns. Financial institutions typically do not charge to complete the transfer of ownership required to complete a gift, so costs are kept to a minimum.

So, why complicate things with an irrevocable trust? Why not just keep the planning as simple and inexpensive as possible? Set up cost is only one consideration. Many important benefits of an irrevocable trust are forfeited when making outright gifts.

Benefits of using an irrevocable trust are:

Asset Protection from Future Creditors of Beneficiaries
A spendthrift provision (that protects trust assets from attachment, foreclosure, garnishment, or other undesirable actions by the creditors of the trust beneficiaries) in a trust can protect the gifted assets from the creditors and predators of the trust beneficiaries.

Preservation of Section 121 Exclusion of Capital Gain on Sale of Principal Residence A properly drafted irrevocable trust can preserve the capital gains tax exclusion of up to $250,000 ($500,000 for a married couple) on the sale of the taxpayer's principal residence. A residence gifted outright to beneficiaries is unlikely to qualify for the exclusion.

Preservation of Step-Up of Basis
Gifted assets receive a "pass through" or "carry over" basis, meaning that the beneficiary of the gift will receive the donor's adjusted cost basis. Assets in a properly drafted irrevocable trust can receive a step-up in basis to the date of death value. For appreciated assets, such as stock or the donor's home, this can be beneficial for minimizing or eliminating capital gains tax when the beneficiary later sells the assets.

Ability to Select Whether Trust Income is Taxable to the Grantor or Beneficiaries
An irrevocable grantor trust can allow the Grantor to be taxed on the trust income even if the grantor does not receive that income. Or, the trust can state that the income will not be taxed to the Grantor.

An outright gift does not give the donor this choice.

Ability to Design Who Will Receive Trust Income

Unlike an outright gift, an irrevocable trust can be designed so that a completed gift is made for Medicaid purposes while allowing the grantor to retain the income from the trust. This is an attractive option for many clients. An outright gift does not give the client that flexibility.

Preserving the beneficiaries' eligibility for governmental benefits, such as Medicaid and Supplemental Security Income (SSI) An outright gift to a disabled person can disqualify him or her from governmental benefits such as Medicaid or SSI. An irrevocable trust can manage the assets for the special needs or disabled beneficiary without causing disqualification from those benefits.

Ability to Specify Terms and Incentives for Beneficiaries' Use of Trust Assets

Many clients desire to infuse their planning for their children or grandchildren with positive aspirations, such as that the gifts or bequests may only be used for education, to finance a career or buy a home. These planning goals can be accomplished with an irrevocable trust though not with an outright gift.

Ability to Decide Which Beneficiaries Will Inherit Upon Settlor's Death

Using a Limited Power of Appointment, an irrevocable allows the grantor the flexibility to modify who within a designated class of beneficiaries will receive distributions from the trust, how much they will receive, and in what way they will receive it. A power of appointment is sometimes referred to as a "power of disappointment" because it retains for the Grantor the power to disinherit a beneficiary.

Ability to Determine Successor Beneficiaries

A major concern in estate planning is who will be the successor beneficiaries if a beneficiary dies before distribution. With an outright gift, the recipient has complete control of the amount received and his creditors (or predators) also may have access to those funds. An irrevocable trust allows the client to designate that only lineal descendants will receive distributions. The client has the option to decide who the possible recipients will be.

Conclusion

With proper planning and drafting, an irrevocable trust can enhance the value of the clients' nursing home and Medicaid planning beyond what can be accomplished through outright gifting. Of course, the potential benefits depend on the design and drafting of the trust. Thoughtful planning and careful drafting is necessary to take advantage of the benefits available.