OSB CLE Seminars

Online CLE

“Take Me Home, Country Roads” Asset Protection Trusts (John Denver)

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From the Oregon State Bar CLE seminar *Advanced Elder Law 2022—“Thinking Out Loud” (Ed Sheeran),* presented on October 7, 2022

Chapter 2

Medicaid Planning with Irrevocable Trusts

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MEDICAID LAW.

1) 42 U.S.C. § 1396p

   a) Look-back period. Five (5) years. See 42 U.S.C. § 1396p(c)(1)(B).

      i) Look-back period is 60 months prior to the date of application or 60 months prior to the date of transfer of assets, whichever is later.

   b) Penalty period. See 42 U.S.C. § 1396p(c)(1)(E).

      i) The number of months of ineligibility shall be equal to the total, cumulative uncompensated value of all of the assets transferred by the individual (or individual's spouse) on or after the look-back date, divided by the average monthly cost to a private patient of nursing facility services in the State at the time of application.

   c) Treatment of irrevocable trusts. See 42 U.S.C. § 1396p(d)(3)(B).

      i) If there are circumstances under which payment from the trust could be made to or for the benefit of the individual, the 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, and payments from that portion of the corpus or income –

         (1) To or for the benefit of the individual, shall be considered income of the individual, and

         (2) For any other purpose, shall be considered a transfer of assets by the individual subject to subsection 42 U.S.C. § 1396p(c) discussed above; and

      ii) Any portion of the (irrevocable) trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual for purposes of subsection 42 U.S.C. 1396p(c) discussed above, and the value of the trust shall be determined for purposes of 42 U.S.C. 1396(c) by including the amounts of any payments made from such portion of the trust after such date.

2) OAR 461-140-0210(5)(b)(B): Look-back period. 5 years (60 months).

   a) OAR 461-140-0210(6): Calculating the duration of the penalty if assets are transferred within 5 years.

i) OAR 461-140-0296: Length of Disqualification (OSIPM).

(1) Total value of non-exempt asset transfers divided by the Average monthly cost of private pay at a nursing facility in Oregon, which is currently $9,551, however it is due to updated annually on October 1 of each year.

ii) OAR 461-140-0296(4)(c)(e)(iv): Disqualification period begins on the Medicaid application date or the date at which the applicant is otherwise eligible for Medicaid, whichever is later.

iii) OAR 461-140-0300: Adjustments to the Disqualification for Asset Transfer [“Curing Transfers”]

(1) OAR 461-140-0300(2):

(a) If ALL funds are returned, the disqualification ends if the transfer that caused the disqualification is rescinded.

(b) If there is a partial return of the transfer that caused the disqualification, then there will be a recalculation of the penalty period to account for the modified transfer.

3) Social Security Administration Programs Operations Manual System (“POMS”).

a) SI 01120.200. Information on Trusts.

i) This section of the POMs provides an overview regarding how SSA defines and treats different types of trusts.

b) SI 01120.201. Trusts established with the Assets of an Individual on or after 01/01/00, which includes the definition of “legal instrument, device or arrangement similar to a trust.”

4) Oregon Programs Eligibility Notebook (available online – see resources for link)

a) Section 5: Financial Eligibility: Availability of assets: Treatment of specific assets: Trusts other than special needs trust, income cap trusts, and pooled trusts.

i) For OSIPM generally *See* Page 356.

ii) For Irrevocable Trusts *See* Page 357.

(1) If the trust is irrevocable, treat as follows: for OSIPM in a non-standard living situation, if, under any circumstances, the funds transferred into the trust are unavailable and the trustee has no discretion in which to distribute funds to or for the benefit of the individual, the individual is subject to a transfer of resources penalty as outlined in the 140 Section of the OARS (beginning with 461-140-0210).

(2) If under any circumstances, payments could be made to or on behalf of the individual, the share of the trust from which the payment could be made shall be considered a resource. For OSIPM individuals in a non-standard living situation, payments made for any reason other than to or for the benefit of the individual shall be considered a transfer or assets subject to disqualification per the 140 Section of the OARS (beginning with 461-140-0210).

(3) If, under any circumstances, income is generated by the trust and could be paid to the individual such income will be considered unearned income. For OSIPM individuals in a non-standard living situation, payments made for any reason other than to or for the benefit of the individual shall be considered a transfer of assets subject to disqualification per the 140 Section of the OARS (beginning with 461-140-0210).

(4) If any change in circumstance, make assets (income or resources) from the trust unavailable to the individual, a disqualifying transfer will be assessed as of the date of the change (again, for OSIPM individuals in a non-standard living situation).

(5) The provisions of this rule may be waived for an irrevocable trust if ODHS OHA determines denial of benefits would create an undue hardship on the individual...

5) Case Law (*Hedlund*) – *Hedlund v. Wisconsin Department,* 807 N.W.2d 672, 337 Wis. 2d 634, 2011 WI App. 153 (Wis. Ct. App. 2011).

   a) Wisconsin case, the Court determines whether assets in an irrevocable trust are available resources for the purposes of determining financial eligibility for medical assistance. The Court held, if there are circumstances under which payment from an irrevocable trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to or for the benefit of the individual could be made is considered a resource available to the individual.

6) CMS Letter
   a) *See Attached*. CMS Letter dated December 23, 1993.

7) HCFA "Transmittal" 64.

<u>TRUST PLANNING CONSIDERATIONS.</u>

1) Types Of Trusts.

   a) Irrevocable Income-Only Trust.

      i) <u>Income</u>: Mandatory distribution standard to or on behalf of settlor(s).

      ii) <u>Principal</u>: Discretionary distribution standard to or on behalf of non-settlor beneficiary or beneficiaries.

      iii) Definition of Trust Income.

         (1) Trust accounting income.

         (2) Income subject to income tax.

         (3) Combination.

         (4) Real estate considerations.

         (5) Oregon Uniform Principal and Income Act (ORS Chapter 129 (UPIA))

   b) Irrevocable (No Income, No Principal) Trust – discretionary distributions to non-settlor(s) beneficiaries during lifetime of settlor(s).

   c) Testamentary special needs trust created pursuant to deceased spouse's will for the primary benefit of the surviving spouse and secondary benefit of the couple's children and more remote descendants.

   d) Trust-like instruments, devices, or arrangements, which require: (see POMS: SI 01120.201.B.5 and 001120.201.G.).

      i) A grantor or individual who provides assets to fund the legal instrument, device or arrangement.

      ii) who transfers property (or whose property is transferred to another); and

      iii) to an individual or entity with fiduciary obligations.

      iv) Examples include, but are not limited to, escrow accounts, investment accounts, guardianship and conservatorship accounts, pension funds, annuities, and Uniform Transfers to Minors Act account.

2) Income Taxation.

   a) Grantor Trust (where trust income, deductions and credits are attributable to the grantor (i.e., settlor or trust creator) and must be reported on that individual's income tax returns (see Internal Revenue Code ("IRC") §§ 671 – 679)).

   b) Non-Grantor Trust (where trust is recognized and subject to income tax as a separate legal entity and the trustee must prepare and file fiduciary income tax returns for the trust (generally, see IRC §§ 641 – 668)).

   c) Stepped-Up Basis. See IRC § 1014(b)(6) (for double-stepped-up basis of *community property* martial property) and (9) (for stepped-up basis for any property included in a decedent's gross estate for estate tax purposes).

      i) As to an irrevocable trust, one way to ensure a stepped-up basis is to have the settlor(s) retain a testamentary limited (or special) power of appointment over the trust assets.

         (1) A retained testamentary limited power of appointment to change remainder beneficiaries of the trust by the settlor will cause the property to be included in his/her gross estate for estate tax purposes pursuant to IRC § 2036(a)(2), which triggers IRC § 1014(b)(9).

         (2) *Community Property (Oregon is not a community property state).* In the case of married couples, a marital property agreement should be entered into stating that assets of the irrevocable trust are classified as martial property in order to realize a double-stepped-up basis upon the death of the first spouse.

3) Gift And Estate Taxation.

   a) Completed gift – removed from gross estate for estate tax purposes, but no stepped-up basis at death. Need to file IRS Form 709 by April 15 in the year after the gift(s) were made.

   b) Incomplete gift – included in gross estate for estate tax purposes, but entitled to receive stepped-up basis at death.

4) Trustee Selection.

   a) Grantor as trustee.

      i) Concern: Trust assets will be deemed available resources for purposes of Medical Assistance eligibility.

      ii) No law or case has made a determination either way.

      iii) If settlor is the trustee, it is advisable to state in the trust document that the settlor is not entitled to receive compensation for services rendered as trustee and reimbursement for expenses incurred as trustee (i.e., settlor must be willing to serve as trustee for free).

   b) Individual or entity other than settlor as trustee – if the settlor is not going to serve as trustee due to concerns of trust assets being deemed available resources, it may be advisable to expressly state in the trust document that the settlor(s) is/are prohibited from being able to serve as trustee or in any other fiduciary capacity. Another question to be answered is whether the settlor(s) can retain a power to remove and replace the trustee with or without cause and whether the type of replacement trustee should be limited, such as to an independent trustee.

   c) Grantor as a directing party.

      i) Can the grantor serve as a directing party as to investments?

      ii) Can the grantor serve as a directing party as to distributions?

      iii) Concern. Same as cited above at (5)(i) - Trust assets will be deemed available resources for purposes of Medical Assistance eligibility.

   d) Grantor holding the power to veto distributions if not the trustee. If the grantor holds an inter vivos veto power, does raise the same concerns as being the trustee and/or serving as a directed party?

5) Retained Testamentary Limited (or Special) Power of Appointment.

   a) *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).

      i) New York, case involving a claim by the State Medicaid Agency that the assets of the applicant's spouse's irrevocable trust were countable for purposes of Medicaid. Terms of the applicant's spouse's irrevocable trust – reserved the right to change the beneficiary. The right was limited, in that settlor was specifically prohibited from naming himself, his spouse, and/or their creditors. The Court held:

(1) Although it was conceivable that settlor could put pressure of beneficiaries to make payments for spouse applicant's benefit, the relevant law stated that the availability of assets, for Medicaid eligibility purposes, depends on the "trustee's authority, under the specific terms of the trust agreement."

(2) Although the trustees and beneficiaries are currently the same people, that is not necessarily so under the terms of the trust... their roles as trustees and beneficiaries must be considered as legally separate.

(3) The speculative possibility of a revocation pursuant to NY 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 revocation.

b) *Verdow v. Sutkowy*, 209 F.R.D. 309 (N.D.N.Y. 2002).

i) New York class action for six elderly nursing home residents who created irrevocable self-settled income only trusts, that were denied Medicaid benefits because the trust 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 on the basis that the settlors could utilize the retained power to change beneficiaries to individuals amenable to revoking an otherwise irrevocable trust. The US District Court held:

(1) The denial of Medicaid benefits because the settlors are allegedly potential beneficiaries of self-settled trusts containing limited powers of appointment exceeds the limits of federal law.

(2) 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.

c) Estate and gift tax impact. See IRC § 2511 and more importantly see 26 Code of Federal Regulations § 25.2511-2 entitled "Cessation of donor's dominion and control."

6) Trustee Powers and Authorities.

   a) Power to sell and purchase – sales and purchases between settlor(s) and trust must be for fair market value.

   b) Power to borrow and lend – should the trustee be able to borrow money from the settlor(s) or lend money to the settlor(s)?

   c) Life insurance – if life insurance is owned by the trust, the trustee should be required to update beneficiary designations if the beneficiary is the settlor(s), creditors of the settlor(s), the estate of the settlor(s), or creditors of the estate of the settlor(s) AND the trustee should be expressly prohibited from being able to designate any of the above as a beneficiary of the policy.

   d) Non-qualified tax-deferred annuities – same advice as for life insurance.

   e) General trustee limitation – the trust should contain a general clause that prohibits the trustee from possessing any power or taking any action that causes or would cause the assets to be deemed available resources as to the settlor(s) for medical assistance purposes; this should also be made to apply to a “special trustee” if the trust document has language authorizing the appointment of a special trustee.

Helpful Links and Resources

42 US Code Section 1396p:

https://www.law.cornell.edu/uscode/text/42/1396p

SSA POMS Generally:

https://search.ssa.gov/search/docs?affiliate=ssa&dc=1585&query=

SSA POMS: Introductions to Trusts.

https://secure.ssa.gov/poms.nsf/lnx/0501120200

SSA POMS: Trust established with the Assets of an Individual on or after 01/01/00

https://secure.ssa.gov/poms.nsf/lnx/0501120201

Oregon SOS Department of Human Services Self-Sufficiency Programs – Chapter 461

https://secure.sos.state.or.us/oard/displayChapterRules.action?selectedChapter=90

Oregon Programs Eligibility Notebook:

https://sharedsystems.dhsoha.state.or.us/DHSForms/Served//de2818.pdf

OSB CLE Materials.

"Issues in the Palette of Medicaid" By Julia Greenfield and Garvin Reiter, Law Office of Nay & Friedenberg that was published in Chapter 2 of the October 2021 "The Art of Elder Law: A Broad Brushstroke Overview" of the Oregon State Bar, CLE Seminar Materials.

Hedlund v. Wisconsin Department, 807 N.W.2d 672, 337 Wis. 2d 634, 2011 WI App. 153 (Wis. Ct. App. 2011)

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).

Verdow v. Sutkowy, 209 F.R.D. 309 (N.D.N.Y. 2002).

Dept. of Health & Human Services,
Health Care Financing Admin.
8325 Security Boulevard
Baltimore, MD 21207

December 23, 1993

Ms. Ellice Fatoullah
Alzheimer's Disease and Re.lated Disorders Association, Inc.
420 Lexington Avenue
Suite 610
New York, New York 10170

Dear Ms. Fatoullah:

I am responding to your letter asking us to confirm your understanding of the meaning of Section 13611(b) of OBRA 93, as codified in section 1917(d)(3)(B)(i) of the Social Security Act (the Act). This section discusses treatment of irrevocable trusts for purposes of determining eligibility for Medicaid.

Briefly, the cited section provides that if there are any circumstances under which payment from an irrevocable trust could be made to or for the benefit of the individual, actual payments made are considered to be income to the individual. Payments that could be made, but are not, are considered resources to the individual. Payments made for any purpose other than to or for the benefit of the individual are treated as a transfer of assets under section 1917(c) of the Act.

You interpret this part of the statute as meaning that, if a person establishes an irrevocable trust guaranteeing the income of the trust to him or herself for life, but excluding distribution of the trust corpus to him or herself, the corpus of the trust will not be considered an available resource to the individual after the applicable transfer of assets waiting period (which you believe to be 60 months). You have asked us to confirm your interpretation.

Your understanding of the statutory requirements is essentially correct. However, as a technic.al point, we would note that the appropriate statutory reference dealing with the situation you describe is section 1917(d)(3)(B)(ii), rather than subsection (I). Subsection (ii) deals specifically with trusts where there is some portion of the trust from which distributions cannot, for any reason, be made to or for the benefit of the grantor. In this situation, the 60 month transfer of assets waiting period to which you refer applies. The section you referenced in your letter actually deals with trusts where some distribution can be made to or for the benefit of the grantor. In such situations, the portion that could be distributed is counted as a resource to the individual. Where distributions can be made, the waiting period for treatment as transfers of assets of distributions made to or for someone other than the grantor is 36 months.

Also, you should understand that where a portion of a trust cannot, under any circumstances, be distributed to or for the benefit of the grantor, that portion is never considered an available resource to the grantor. Rather, the value of that portion of the trust is treated as a transfer of assets for less than fair market value. An individual who transfers assets for less than fair market value can still be eligible for Medicaid. However, the Medicaid program will not pay for the cost of various long term care services, including nursing facility care. The length of time for which payment for services would be denied would depend on the value of the transferred asset (or, in the situation you describe, the value of that portion of the trust which cannot be paid to or for the benefit of the grantor).

I hope this information is useful to you.

Sincerely,

Sally K. Richardson Director
Medicaid Bureau

MEDICAID PLANNING WITH IRREVOCABLE TRUSTS

Presented By:
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MEDICAID LAW

- FEDERAL
- OREGON
- SOCIAL SECURITY ADMINISTRATION PROGRAMS OPERATION MANUAL SYSTEM (POMS)
- Other Sources

MEDICAID LAW – 42 U.S.C. § 1396P

- Look-back period. Five (5) years. See 42 U.S.C. § 1396p(c)(1)(B).
- Penalty period. See 42 U.S.C. § 1396p(c)(1)(E).
- Treatment of irrevocable trusts. See 42 U.S.C. § 1396p(d)(3)(B).
    - Payment from the Trust to or for the benefit of Medicaid applicant?
    - Available Resource verses Transfer of Assets?

MEDICAID LAW – OREGON ADMINISTRATIVE RULES

- OAR 461-140-0210(5)(b)(B): Look-back period. 5 years.
- OAR 461-140-0210(6): Calculating the duration of the penalty if assets are transferred within 5 years:
    - OAR 461-140-0296: Length of Disqualification (OSIPM)
    - OAR 461-140-0300: Adjustments to the Disqualification for Asset Transfer

MEDICAID LAW – SOCIAL SECURITY ADMINISTRATION PROGRAMS OPERATIONS MANUAL SYSTEM (“POMS”).

- SI 01120.200. Information on Trusts.
- SI 01120.201. Trusts established with the Assets of an Individual on or after 01/01/00, which includes the definition of “legal instrument, device or arrangement similar to a trust.”

MEDICAID LAW – OREGON PROGRAMS ELIGIBILITY NOTEBOOK

Oregon Programs Eligibility Notebook
https://sharedsystems.dhsoha.state.or.us/DHSForms/Served//de2818.pdf

- Section 5: Financial Eligibility: Availability of assets: Treatment of specific assets: Trusts:
  - For OSIPM generally *See* Page 356.
  - For Irrevocable Trusts *See* Page 357.

MEDICAID LAW – OTHER SOURCES

- Case Law (Hedlund)
- CMS Letter
- HCFA “Transmittal”64

TYPES OF TRUSTS

INCOME TAXATION

GIFT AND ESTATE TAXATION

TRUSTEE SELECTION

RETAINED TESTMENTARY LIMITED (OR SPECIAL)POWER OF APPOINTMENT
TRUSTEE POWERS AND AUTHORITIES

TRUST PLANNING CONSIDERATIONS

TYPES OF TRUSTS

- IRREVOCABLE – INCOME ONLY: Mandatory income distribution standard to or on behalf of settlor(s). Discretionary principal distribution standard to or on behalf of non-settlor beneficiary or beneficiaries.

- IRREVOCABLE – NO INCOME, NO PRINCIPAL: Discretionary distributions to non-settlor(s) beneficiaries during lifetime of settlor(s).

- TESTAMENTARY SPECIAL NEEDS TRUST FOR SPOUSE: Special needs trust created pursuant to deceased spouse's will for the primary benefit of the surviving spouse and secondary benefit of the couple's children and more remote descendants.

- TRUST LIKE INSTRUMENTS: See POMS: SI 01120.201.B.5 and 001120.201.G.

INCOME TAXATION

Grantor Trust

Grantor Trust (where trust income, deductions and credits are attributable to the grantor and must be reported on that individual's income tax returns (see Internal Revenue Code ("IRC") §§ 671 – 679)).

Non-Grantor Trust

Non-Grantor Trust (where trust is recognized and subject to income tax as a separate legal entity and the trustee must prepare and file fiduciary income tax returns for the trust (generally, see IRC §§ 641 – 668)).

STEPPED UP BASIS

SEE IRC § 1014(B)

As to an irrevocable trust, one way to ensure a stepped-up basis is to have the settlor(s) retain a testamentary limited (or special) power of appointment over the trust assets.

For Example: A retained testamentary limited power of appointment to change remainder beneficiaries of the trust by the settlor will cause the property to be included in their gross estate for estate tax purposes pursuant to IRC § 2036(a)(2), which triggers IRC § 1014(b)(9).

GIFT AND ESTATE TAXATION

Completed Gift

Removed from gross estate for estate tax purposes, but no stepped-up basis at death. Need to file IRS Form 709 by April 15 in the year after the gift(s) were made.

Incomplete Gift

Included in gross estate for estate tax purposes but entitled to receive stepped-up basis at death.

TRUSTEE SELECTION

- Grantor as Trustee
  - Concern: Trust assets will be deemed available resources for purposes of Medical Assistance eligibility.
- Individual or entity other than Settlor:
- Grantor as a directing party?
  - Can the grantor serve as a directing party as to investments?
  - Can the grantor serve as a directing party as to distributions?
  - Same concern as above.
- Grantor holding the power to veto distributions?
  - Same concern as above.

RETAINED TESTAMENTARY LIMITED (OR SPECIAL) POWER OF APPOINTMENT

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).

Verdow v. Sutkowy, 209 F.R.D. 309 (N.D.N.Y. 2002).

Estate and gift tax impact. See IRC § 2511 and more importantly see 26 Code of Federal Regulations § 25.2511-2 entitled “Cessation of donor’s dominion and control.”

TRUSTEE POWERS AND AUTHORITIES

- Power to sell and purchase – sales and purchases between settlor(s) and trust must be for fair market value.
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- General trustee limitation – the trust should contain a general clause that prohibits the trustee from possessing any power or taking any action that causes or would cause the assets to be deemed available resources as to the settlor(s) for medical assistance purposes; this should also be made to apply to a "special trustee" if the trust document has language authorizing the appointment of a special trustee.

QUESTIONS?

THANK YOU!

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