

# ELDER LAW

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# ADVISORY

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## VETERANS BENEFITS CAN HELP VETERANS AND THEIR SPOUSES PAY FOR HOME CARE AND ASSISTED LIVING

By Robert C. Anderson\*

### Introduction

One of the U.S. Department of Veterans Affairs' (VA) best-kept secrets is an excellent source of tax-free funds to pay long-term care costs, typically at home or in an assisted living facility. It is a group of benefits called the Special Monthly Pensions (SMP) of the VA's Improved Pension program for *non-service connected* disabilities for wartime veterans and their spouses.<sup>1</sup> While almost all veterans have heard of *service-connected* compensation, very few are aware of this program.

The top level of SMP benefits is *Aid and Attendance* (A&A). This benefit is for veterans and spouses who are housebound and need help with their basic daily activities.<sup>2</sup> The maximum monthly benefits for A&A in 2011 are:<sup>3</sup>

- Veteran with no dependents  
\$1,644/month
- Veteran with one dependent  
\$1,949/month

- Widow(er) with no dependents  
\$1,056/month
- Healthy veteran with ill spouse  
\$1,291/month

The next level of SMP is called housebound benefits. This benefit is for veterans and spouses who are housebound but do not need help with their basic daily activities.<sup>4</sup> The maximum monthly benefits for 2011 are:<sup>5</sup>

- Housebound veteran with no dependent \$1,204/month
- Housebound veteran with one dependent \$1,510/month
- Housebound widow(er) with no dependents \$ 808/month

A&A and housebound benefits can be a real blessing for a wartime veteran or his or her spouse who needs long-term care services which he or she cannot afford.

**Example 1:** George served in WWII and is married to Elaine. He enters the Happy Care Assisted Living Facility due to his Parkinson's disease. The cost of care is \$3,400 per month. In George's State, Medicaid assistance is not available to cover costs at an assisted living facility. The combined monthly income of the couple is not enough to cover George's cost of care and Elaine's

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remaining expenses. Assuming that George meets all eligibility rules for A&A, he can receive up to \$1,949 per month.

**Example 2:** Mary, age 75, is a widow of a war-time veteran who needs home health care of \$2,000 per month to help her with bathing, dressing, and taking medications. Assuming Mary meets all eligibility rules for A&A, she can receive up to \$1,056 per month.

A third *non-service connected* Improved Pension is low-income disability benefits based on a veteran being 65 or older.<sup>6</sup> This benefit is generally not used to cover long-term care costs.

This article will explain the eligibility rules of the program, how elder law attorneys can help achieve eligibility, how tax and Medicaid traps can be avoided, and how attorneys can become VA accredited, including when an attorney can and can not be compensated. It should be noted that the coverage in this article of the VA Improved Pension program is limited. Effective advice will depend on mastering the many additional rules not covered in this article.

## Eligibility Rules

In order to receive either A&A or housebound benefits, a veteran or widow(er) of a veteran must satisfy all of these criteria:

- (1) *Wartime service.* The veteran must have served at least 90 days of consecutive active duty service, one of which must have been during a war-time period.<sup>7</sup> The veteran need not have served in combat.
- (2) *Discharge status.* The veteran must have received a discharge other than dishonorable.<sup>8</sup>
- (3) *No willful misconduct.* The disability must not have been caused by the willful misconduct of the claimant.<sup>9</sup>
- (4) *Disabled status.* The claimant must be considered permanently disabled.<sup>10</sup> Disability criteria vary according to whether A&A or housebound benefits are desired.
- (5) *Income test.* The veteran or widow(er) is expected to share his or her income in

covering long-term care costs. Therefore, the application will be denied if countable income exceeds the maximum annual pension rate (MAPR).<sup>11</sup> The income of both the veteran and the veteran's spouse are considered. The good news is that the claimant's and the spouse's out-of-pocket unreimbursed medical expenses (UMEs) can be deducted in bringing his or her income below the MAPR.<sup>12</sup>

The cost of home health care—even performed by a family member—is an allowable UME as long as the service provider performs nursing care or other medical care, such as help with bathing, dressing, or taking medications. The full unreimbursed cost of an assisted living facility or nursing home also qualifies for UME.

- (6) *Net worth test.* The claimant is also expected to share his or her countable assets in covering long-term care costs.<sup>13</sup> The countable assets of both the veteran and his or her spouse are considered. How much assets the claimant can keep is a frustrating, moving target that now depends on the claimant's age, life expectancy, income from other sources, family expenses, convertibility into cash of the assets involved, and unusual medical expenses.<sup>14</sup>

According to experienced VA Accredited Attorney Dale M. Krause, while websites and publications indicate that a claimant can have up to \$80,000 of countable assets, older Korean and World War II veterans and their surviving spouses should retain not more than \$30,000 of countable assets to assure consideration.<sup>15</sup>

In considering net worth, the VA excludes the claimant's dwelling including a reasonable lot area, and personal effects.<sup>16</sup> Land contiguous to the home, but beyond the home's surrounding lot is countable. The fair market value of other assets is countable.<sup>17</sup>

Also, it is noteworthy that unlike the Medicaid program for skilled nursing home care, the VA does not penalize gifts or transfers of asset or income

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made prior to the application,<sup>18</sup> although they are reportable on the application, VA Form 21-526. Assets transferred to a relative residing in the claimant's household however, are still considered as being owned by the claimant.<sup>19</sup>

## How the Elder Law Attorney Can Help

As of June 23, 2008, attorneys must be accredited with the VA Office of General Counsel by filing VA Form 21a in order to provide assistance in the preparation, presentation, and prosecution of claims before the VA.<sup>20</sup> The form may be downloaded from the VA website at <http://www.va.gov/vaforms/va/pdf/VA21a.pdf>. Being a member in good standing of any state bar will initially qualify an attorney for accreditation.<sup>21</sup>

The attorney must then complete three hours of qualifying continuing education on VA benefits within one year of receiving a notice of accreditation.<sup>22</sup>

The only other representatives who have legal authority to help prepare, file and prosecute claims are: (1) trained members of a Veterans Service Organization (VSO),<sup>23</sup> e.g., American Legion, VFW, DAV, or state/county VA office, or (2) an agent who has received VA training and has passed a test provided by the VA.<sup>24</sup> Any person not accredited, who provides specific VA advice, even on a pro bono basis, to a veteran who expresses a desire to file a VA claim is practicing VA law contrary to VA rules.<sup>25</sup> Moreover, no one, including accredited attorneys, VSO representatives, and accredited non-attorney agents can charge a fee in connection with the preparation, filing and prosecution of a claim.<sup>26</sup>

## How to Get Paid

Getting paid for helping a veteran or a surviving spouse in applying for VA benefit is a challenge. A violation of the rules can subject an attorney or non-attorney representative with potential administrative and criminal consequences.<sup>27</sup>

A letter dated May 24, 2004, from the VA's General Counsel to U.S. Representative Lane Evans (D-IL) helps to clarify when an attorney may charge a fee.<sup>28</sup> The letter concludes that attorneys may charge for pre-filing consultative services that a "potential" VA claimant might actually need, short of actually preparing and presenting a "specific" claim for benefits.<sup>29</sup>

Once the veteran or surviving spouse expresses a desire to file a VA claim, no fees can be charged for services related to the claim. Prior to express-

ing a desire to file a claim however, charges for advice on Medicaid, Medicare, estate planning services, preparation of a trust for asset transfers, and general VA advice, etc., are permitted. Victoria Collier,<sup>30</sup> a VA accredited attorney and nationally-known lecturer on VA benefits, recommends that the attorney, make it clear to the veteran/spouse at the initial client meeting that before a specific discussion on the client's eligibility for any government benefits is started, the client's estate planning needs must first be attended to.

Of course, after the client has expressed a desire to file a VA claim, any work performed by the attorney to prepare, file, and prosecute the claim must be done for free. It is recommended that these matters be clearly spelled out in the fee agreement.

An attorney may also receive a fee for VA appeals after a Notice of Disagreement has been filed, provided a fee agreement has been approved by the VA's Office of General Counsel.<sup>31</sup>

## Alternative Practice Models

In my practice, we engage a competent Veteran Service Office (VSO) to handle the filing and prosecution of claims. Our role is to provide general pre-filing advice, asset transfer assistance and estate planning representation, for which we can be paid. Once these tasks are completed and it is determined that countable assets are below \$30,000, we then refer the veteran to a VSO to file a claim for A&A or housebound benefits. Any additional services we provide after this point are performed on a pro bono basis.

Another equally viable practice model is not to refer the matter to a VSO but rather for the accredited attorney to prepare, file, and prosecute all aspects of a VA claim. None of these services can be paid for. Of course, it is assumed that the law firm can receive a fee for estate planning and other general legal advice needed before starting a claim.

Regardless of which practice model is selected, it is recommended that the accredited attorney subscribe to a reliable membership service offering a list serve and computer-based forms. An excellent service is Veteran Advocates Group of America (VAGA) and VisPro software and list serve.<sup>32</sup>

## Effective Transfer Strategies

### *Beware of Medicaid Consequences and Retained Life Estates*

As stated above, unless a veteran makes a gift or transfer to a person in the veteran's household, the gift or transfer will not disqualify the veteran

from VA benefits.<sup>33</sup> However, if the veteran later enters a nursing home within 60 months of the transfer, the veteran will face a Medicaid period of ineligibility.<sup>34</sup> In order to cure the Medicaid divestment penalty, the transferred assets may have to be returned to the veteran.

A cautionary comment is needed for deeds to beneficiaries in which the veteran retains a life estate. The VA rules depart from traditional legal treatment of retained life estates by continuing to count not only the veteran's retained life estate but also the remainder interest given to others based on the theory that the veteran did not completely relinquish the veteran's full interest in the property.<sup>35</sup>

### *Comparing Outright Transfers to Transfers Into Trusts*

The two principal transfer options are an outright transfer or a trust transfer. Keep in mind that a VA/IRS match will pick up taxable income reported to the veteran's social security number. Therefore, whichever transfer option is selected, it is important that the taxable income from the transferred assets not be reported to the veteran, otherwise the veteran's eligibility may be delayed, scrutinized, or denied.

An outright transfer of assets into the name or names of trusted loved ones offers simplicity in comparison to a transfer into trust. However, keep in mind that assets in an outright transfer will be owned by a loved one who has the power to consume the asset, and may lose part or all of the asset in a divorce, creditor action, or to other legal claims.

Holding the asset in a trust is a safer alternative. When land, stocks, mutual funds, and other capital assets are involved, a properly-drafted trust will capture a stepped-up tax basis under Internal Revenue Code § 1014.<sup>36</sup> This allows the trust beneficiaries, upon the veteran's death, to receive a new tax basis (usually stepped-up) to the fair market value at time of death.<sup>37</sup> This important tax advantage will be lost when an outright transfer is used in which event the veteran's lower tax basis carries over to the recipient at the time of the gift<sup>38</sup> and can result in capital gains taxes later when the asset is sold.

### *Designing an Effective Trust*

If a trust is preferred as the transfer method, tax consequences should be considered in addition to public benefit eligibility. The design should not only satisfy VA countability rules but if a veteran later enters a nursing home, Medicaid countability

rules should also be considered. While federal Medicaid rules will not count the principal of a properly-designed trust which pays income to a Medicaid applicant,<sup>39</sup> the VA rules can be interpreted as counting the principal of a trust which pays income to the veteran.<sup>40</sup> It is for this reason that the author recommends the use of an *irrevocable* trust in which no income is payable to the veteran in a *non-grantor simple trust* formulation for income tax purposes. In client discussions, we refer to this trust as a Veterans Eligibility Trust (VET).

In setting up a VET, the veteran is the settlor, retains no right to amend or revoke, and transfers assets into the trust. A trusted person serves as trustee. Certain family members or others are beneficiaries who will be entitled to receive *mandatory trust income*. It is critical that the trust states that the veteran has no right to receive any income or principal, nor retains any other right other than a *testamentary special power of appointment*. Since the veteran has no access or control over trust assets, the assets in trust will be exempt from VA countability rules<sup>41</sup> (subject to no transfer penalty) and after a 60-month look-back period will be exempt from the Medicaid look-back rule.<sup>42</sup>

Under a VET, the veteran is a mere nominal trust grantor and will not retain any powers which will cause the trust to be treated as a *grantor trust for income tax purposes*.<sup>43</sup> The trust will be treated as a non-grantor trust.<sup>44</sup> The non-veteran beneficiaries will be entitled to receive mandatory interest, dividends, *capital gains* and other income. As a result, the beneficiaries will be taxed on trust income, and the trust will be treated as a *simple trust* for income tax purposes.<sup>45</sup> In this way, trust taxable income will not be reported on the veteran's tax return, nor will income be taxed to the trust at highly compressed rates.<sup>46</sup> The non-veteran beneficiaries will be able to use the trust's income to cover his or her tax on the taxable income.

In order to avoid gift tax reporting and capture a stepped-up tax basis for appreciated capital assets, the veteran will retain a *testamentary special power of appointment (SPA)*.<sup>47</sup> A testamentary SPA is one that is exercised in a Last Will & Testament which is effective only after death. Since it is possible that a VA adjudicator or a Medicaid agency may challenge eligibility if a veteran retains a *lifetime SPA*, a veteran's retained *testamentary SPA* is a safer strategy.<sup>48</sup>

In order to make it clear that the veteran's retained testamentary SPA will not cause the veteran to report tax on the trust's income by triggering *grantor trust status*, the exercise of

the *testamentary SPA* should require the advance consent of a non-veteran trust beneficiary.<sup>49</sup>

A sample provision that creates an effective *testamentary SPA* provides: “Grantor, with the advance consent of any primary beneficiary designated herein, may designate or appoint in his or her Last Will or Testament trust property including corpus to any individual(s) other than himself (herself), his or her estate, his or her creditors, or the creditors of his or her estate.”

The author recommends that if the veteran requires more income to cover care costs or other expenses, the veteran should consider the purchase of an immediate income annuity which converts countable assets into an income stream in the veteran’s name rather than a trust which provides income to the veteran (see discussion below on annuities).

### *Handling the Home*

The veteran’s home presents special tax and public benefits issues. Under VA regulations, a veteran’s home clearly enjoys an exempt status for purposes of A&A and housebound pension, even if the veteran leaves his or her home to enter an assisted living facility, or to live with another or rents the home out.<sup>50</sup> An additional problem comes when the home is later sold after applying for A&A. If the veteran still owns the home, such a sale is reportable to the VA and may cause the loss of A&A.<sup>51</sup>

To avoid this result, the home can be transferred into a VET before applying for A&A. The VET will then sell the home. However, since the VET is a *non-grantor trust*, the veteran’s home-sale capital gains exemption under I.R.C. § 121 will be lost unless the VET contains one or more tax saving provisions, which create grantor trust status as to a home sale only and thus satisfy I.R.C. § 121.<sup>52</sup> One savings provision in the VET provides that “capital gains from the sale of the homestead shall be allocated to trust principal.”<sup>53</sup> A second savings provision provides that the veteran will have the right to occupy the residence and to re-vest the home in his or her own name.<sup>54</sup> A third way to create grantor trust status for a home sale is to include a power to exchange property of equal value with the home.<sup>55</sup>

The home sale proceeds will be reported on a 1099 issued to the VET’s tax ID rather than the veteran’s social security number. To make matters even better under IRS rules, an excluded sale of a primary residence is not reportable to the IRS,<sup>56</sup> and therefore would not be picked up by the VA

in an IRS/VA match. Keep in mind that the sales proceeds will be retained in the VET, and will no longer be subject to the special provision allocating home sale proceeds to principal but rather future income therefrom will be allocated to the income distributable to the non-veteran beneficiaries.

Another issue is that the VA homestead exemption only applies to a small land lot surrounding the home and not to other excess land contiguous to the home.<sup>57</sup> Therefore, if there is any land surrounding veteran’s home which the VA may perceive as being excess, the home and surrounding land should be transferred into the VET.

### *Proper Use of Annuities*

An alternative way to reduce countable assets is for the veteran to use excess assets to purchase an immediate monthly payout annuity—which the VA will treat as income rather than as an asset.<sup>58</sup> Dale Krause, a VA accredited attorney and annuity specialist, points out that the immediate annuity option to a transfer option is attractive to the veteran who wants to maintain a degree of control because the immediate annuity will be owned by the veteran. He recommends that monthly annuity payments can be designed to bring a veteran’s monthly income less unreimbursed Medicaid expenses up to no more than the monthly MARP. If a nursing home admission may occur in the future, the applicable state’s Medicaid requirements for an acceptable immediate annuity should also be considered in designing the annuity.

**Example 3:** George and Elaine from example 1 above have combined monthly income of \$2,100 and \$80,000 in countable assets. George’s cost of care at Happy Care ALF is \$3,400 per month. Before applying for A&A, George uses \$50,000 to purchase an immediate annuity which pays him \$1,300 per month, bringing their net cash flow (\$2,100 plus \$1,300) up to an amount equal to the \$3,400 of cost of care. As result, George should be able to receive the full A&A of \$ 1,949 per month.

While annuities are viable options, it is unfortunate that there are unscrupulous annuity salespersons who are not VA Accredited offering annuities and unauthorized specific advice on VA benefits to veterans who have expressed an interest in filing a VA claim. The author recommends that such unauthorized activities be reported to the VA Deputy Assistant General Counsel,<sup>59</sup> your state bar’s unauthorized practice of law office, and your state insurance commission.

## Conclusion

Unlike the very specific rules used in determining Medicaid eligibility, the decisions relating to allowable net worth for the VA Improved Pension for A&A and housebound benefits are more subjective. Transfers by veterans do not create an ineligibility period for the VA Improved Pension, but must be disclosed on the veteran's new application, VA Form 21-526. Transfers by a widow(er) are not even reportable on the VA's separate widow(er)'s application for benefits, VA Form 21-534. Also, any transfers must be analyzed to determine if there would be adverse results if Medicaid were needed during any Medicaid disqualification period. Transfers may be outright or into an effective trust. Another common planning technique is converting assets into income by purchase of an annuity, provided the increased income will not cause loss of the benefit. Family members except a spouse can be paid caregivers, which is deductible UME.

The VA's housebound and A&A disability pension offers an excellent source of funds to help wartime veterans and widow(er)s of wartime veterans stay at home or finance part of the cost of assisted living. A&A is not generally available to pay nursing home costs if Medicaid is obtained. The role of the elder law attorney is important—whether the attorney takes a limited catalyst role or as a start-to-finish role. Our veterans deserve these benefits and our help to capture them.

**Robert C. Anderson, LL.M** *Taxation, is a VA Accredited Attorney, and a Certified Elder Law Attorney. Mr. Anderson serves on the Board of the National Academy of Elder Law Attorneys and is licensed in Michigan and Wisconsin. The author expresses his appreciation for the help that elder law attorneys Rick Law of Illinois and Robert A. Mason of North Carolina provided in writing this article.*

1. Special Monthly Pensions are part of the VA's Improved Pension authorized under 38 U.S.C.A. §§ 1501 et seq. The term "non-service connected" means that the disability at issue was not related to an injury or disease occurring during or caused by military service. Also note that these benefits may be used to pay for skilled nursing home care—that is until Medicaid is obtained, at which point VA benefits will be terminated.

2. To be eligible for Aid & Attendance the claimant must be (1) a patient in a nursing home [an assisted living facility is considered a nursing home 38 U.S.C.A. § 101(28)] or (2) blind or significantly disabled as to need or require the regular aid and attendance of another person. 38 U.S.C.A. § 1502(b).

3. See U.S. Department of Veterans Affairs, Benefits Rate Tables, available at <http://www.vba.va.gov/bln/21/rates/index.htm>.

4. To be eligible for a housebound pension, the claimant must be substantially confined to such veteran's house due to a disability which is reasonably certain to remain throughout such veteran's lifetime. 38 U.S.C.A. § 1502(c).

5. See U.S. Department of Veterans Affairs, Benefits Rate Tables, available at <http://www.vba.va.gov/bln/21/rates/index.htm>.

6. Any veteran age 65 or older is presumed to be permanently and totally disabled for qualifying for a low income disability pension. Pub. L. No. 107-103; 38 U.S.C.A. § 1513.

7. See 38 U.S.C.A. § 1521(j). The periods of wartime are designated by Congress in 38 U.S.C.A. § 101(6) to (11); 38 C.F.R. § 3.2. Note that there are exceptions to the 90-day active service rule.

8. 38 U.S.C.A. § 5303.

9. 38 U.S.C.A. § 1521(a).

10. See footnotes 2, 4, and 6, supra.

11. See Stichman and Abrams, National Veterans Legal Services Program (NVSLP), Veterans Benefits Manual, Par. 6.2.1 (2008).

12. 38 U.S.C.A. § 1503(a)(8).

13. 38 U.S.C.A. § 1522.

14. U.S. Department of Veterans Affairs, VA Compensation and Pension Manual, M21-1MR, Part 5, Subpart iii, Chapter 1, Sec. J, Topic 70a, available at [http://www.benefits.va.gov/warms/M21\\_1MR.asp](http://www.benefits.va.gov/warms/M21_1MR.asp); 38 C.F.R. § 3.275.

15. Dale M. Krause, JD, LL.M., DePere, Wisconsin.

16. 38 C.F.R. § 3.275(b).

17. 38 C.F.R. § 3.275(b).

18. 38 C.F.R. § 3.276(b). However, to consider gifted assets as being non-countable, it must be clear that the claimant has relinquished all rights of ownership and control over the gifted assets.

19. 38 C.F.R. § 3.276(b).

20. 38 C.F.R. § 14.629(b)(1).

21. 38 C.F.R. § 14.629(b)(1)(ii).

22. 38 C.F.R. § 14.629(b)(1)(iii).

23. 38 C.F.R. § 14.628.

24. 38 C.F.R. § 14.629(b) (an individual with a one-time permission from the VA may assist one claimant without being accredited).

25. 38 C.F.R. § 14.629(b)(1).

26. 73 Fed. Reg. 29852-01, 29866. An exception is a payment from a third party.

27. See Stichman and Abrams, National Veterans Legal Services Program (NVSLP), Veterans Benefits Manual, p. 1501 (2008).

28. Letter from Tim S. McClain, VA General Counsel to U.S. Rep. Lane Evans (D-IL). A copy of this letter is available on the National Veterans Legal Services Program's (NVLSP) website at <http://www.nvlsp.org/Information/ArticleLibrary/images/attorneyfees-LaneEvansdoc.pdf>.

29. Letter from Tim S. McClain, VA General Counsel to U.S. Rep. Lane Evans (D-IL). A copy of this letter is available on the National Veterans Legal Services Program's

(NVLS) website at <http://www.nvlsp.org/Information/ArticleLibrary/images/attorneyfees-LaneEvansdoc.pdf>.

30. Victoria L. Collier, Decatur, Georgia.
31. Pub. L. No. 109-461, § 101(h).
32. Information regarding VisPro can be found at Veterans Information Services, Inc., <http://www.info4vets.com/>.
33. 38 C.F.R. §§ 3.275(b), 3.276(b).
34. See 42 U.S.C.A. § 1396p(c).
35. See 38 C.F.R. § 3.276(b); Vet. Aff. Op. Gen. Couns. Prec. 15-92.
36. I.R.C. § 1014(a)(4) (assuming that the trust involved will result in estate tax inclusion under I.R.C. §§ 2036, 2037, 2038, or 2041).
37. I.R.C. § 1014(a)(4).
38. I.R.C. § 1015.
39. Letter from Sally K. Richardson, Director, Medicaid Bureau, Health Care Financing Administration, to Ellice Fatoullah (Dec. 23, 1993).
40. See 38 C.F.R. § 3.276(b) which provides that the VA will only recognize a transfer [and thus not count the transferred asset] if the veteran has relinquished all rights of ownership [including the right to income]; VA Compensation and Pension Manual, M21-1MR, Part 5, Subpart iii, Chapter 1, Sec. I, Topic 56(a) and (b), available at [http://www.benefits.va.gov/warms/M21\\_1MR.asp](http://www.benefits.va.gov/warms/M21_1MR.asp).
41. The VA's regulations do not provide direction on how to formulate a trust which is exempt. The VA General Counsel has issued several imprecise opinions which hold that trust assets will be considered as exempt as long as the veteran "has retained no right or interest in the property or income there from and cannot exert control over these assets for the veteran's own benefit." See Vet. Aff. Op. Gen. Couns. Prec. 73-91. See also Vet. Aff. Op. Gen. Couns. Prec. 64-91.
42. See 42 U.S.C.A. § 1396p(d)(3)(B)(i).
43. The often-used grantor trust powers for Medicaid asset protection trusts, such as a power to exchange property of an equivalent value under I.R.C. § 675(4)(c) and others found in I.R.C. §§ 673 to 678, must not be included in a VET. Also, to prevent the application of I.R.C. § 678, the VET must contain a provision that requires a trustee to obtain the consent of another person before he or she can distribute income to or for his or her own benefit.
44. Non-grantor trusts are taxed under I.R.C. §§ 644 to 667.
45. See I.R.C. § 651.
46. See I.R.C. § 1(a) to (e).
47. A retained testamentary special (or limited) power of appointment will prevent a gift from being completed for gift tax purposes under Treas. Reg. § 25.2511-2(b) and result in inclusion for estate tax purposes under I.R.C. §§ 2036(a)(2) and 2038 and thus confer a step-up under I.R.C. § 1014(b)(4).
48. See *Doherty v. Director of Office of Medicaid*, 74 Mass. App. Ct. 439, 908 N.E.2d 390 (2009).
49. By requiring the consent of another to designate or appoint, the grantor trust-triggering provision of

I.R.C. § 674(a) is avoided; and to be extra sure it is important to add a clause which prevents the trustee from accumulating income (see Treas. Reg. § 1.674(b)-1(b)(3)).

50. Vet. Aff. Op. Gen. Couns. Prec. 64-91, item 5. (moving out of the home renting it after a veteran leaves may give a VA adjudicator reasons to incorrectly deny the home's exempt status).
51. 38 U.S.C.A. § 1503(a)(6); 38 C.F.R. § 3.262(k)(4).
52. Treas. Reg. § 1.121-1(c)(3) (application of a grantor trust provision to satisfy I.R.C. § 121 must apply to principal rather than to just income). See Rev. Rul. 85-45, 1985-1 C.B. 183.
53. Such a provision captures grantor trust status as to capital gains under Treas. Reg. § 1.674(b)-1(b)(3) and Treas. Reg. § 1.671-3.
54. See I.R.C. § 676, which creates grantor trust status when grantor has the power to revest principal. See Rev. Rul. 66-159, 1966-1 C.B. 162. However, such a power may result in Medicaid countability in some states or estate recovery in others.
55. I.R.C. § 675(4)(C).
56. IRS Pub. 523.
57. 38 C.F.R. § 3.275(b).
58. An irrevocable immediate annuity has no cash surrender value and thus satisfies 38 C.F.R. § 3.275(d)'s rule that property cannot "be readily converted into cash."
59. Report to U.S. Department of Veterans Affairs, Office of General Counsel at [ogcaccrreditationmailbox@va.gov](mailto:ogcaccrreditationmailbox@va.gov).

## RECENT CASE SUMMARIES

### Provision In Trust Stating Settlor's Intent That Disputes Be Resolved By Arbitration Not Enforceable

In a matter of first impression in Texas, the Court of Appeals of Texas, in *Rachal v. Reitz*, 2011 WL 2937442 (Tex. App. Dallas 2011), held that a provision in a trust stating the settlor's intent that disputes involving the trust be resolved by arbitration was not enforceable as a contract.

John W. Reitz [hereinafter "Appellee"] was the beneficiary of a trust established by his father, A.F. Reitz [hereinafter "Reitz"]. Under the terms of the trust, Reitz was the sole initial trustee and his attorney, Hal Rachal, Jr. [hereinafter "Appellant"], was named successor trustee. Appellant became trustee after Reitz's death.

Appellee filed a lawsuit against Appellant, individually and as successor trustee. The lawsuit alleged that Appellant had failed to provide an accounting on behalf of the trust as required by

statute and breached his fiduciary duty by failing to account and by hiding his systematic looting of the trust for personal gain. The lawsuit also alleged that Appellant should be removed as trustee. Appellant filed a motion to compel arbitration pursuant to a provision contained in the trust. That provision provided:

*Arbitration.* Despite anything herein to the contrary, I intend that as to any dispute of any kind involving this Trust or any of the parties or persons concerned herewith (e.g. beneficiaries, Trustees), arbitration as provided herein shall be the sole and exclusive remedy ...

The trial court denied the motion. Appellant filed an interlocutory appeal.

The court began its analysis with a discussion of Texas law regarding arbitration. Specifically, the court noted that a party cannot be compelled to arbitrate a dispute where the party has not agreed to do so. See, e.g. *Roe v. Ladymon*, 318 S.W.3d 502 (Tex. App. Dallas 2010). Under **Tex. Civ. Prac. & Rem. Code § 171.021(a)**, the party seeking to compel arbitration must show the existence of an agreement to arbitrate. The trial court will make this determination by applying standard contract principles. If the trial court finds that a valid arbitration agreement exists, the burden then shifts to the party opposing arbitration to raise an affirmative defense to enforcement. See, e.g. *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 20 I.E.R. Cas. (BNA) 1315 (Tex. 2003).

The court then turned to whether Appellant had proved the existence of an agreement to arbitrate. The court pointed to five elements for the formation of a valid contract: (1) an offer, (2) acceptance in strict compliance with the terms of the offer, (3) a meeting of the minds, (4) each party's consent to the terms, and (5) execution and delivery of the contract with the intent that it be mutual and binding on the parties to the agreement. Moreover, the court noted that consideration is a fundamental element. See *Gables Central Const., Inc. v. Atrium Companies, Inc.*, 2009 WL 824732 (Tex. App. Dallas 2009), reh'g overruled, (Oct. 13, 2009) and petition for review filed, (Dec. 14, 2009).

The court noted that neither Appellant nor Appellee had signed the trust document as parties to the trust. The trust, which was the sole evidence submitted in support of the Appellant's motion, merely expressed the settlor's intent. The court stated that Appellant did not establish how the settlor's expression of intent satisfied all of the required elements of contract. Moreover, the

Appellant did not demonstrate how the settlor's expression of intent transformed the trust provision into an agreement to arbitrate between Appellant and Appellee.

The court then pointed out that whether a provision stating the settlor's intent that disputes involving the trust be resolved by arbitration was enforceable as a contract was a matter of first impression in Texas. The court indicated that only two jurisdictions in the country had considered the issue and that both concluded that a trust was not a contract and that a beneficiary of a trust could not be compelled to arbitrate disputes arising under the trust. See *Schoneberger v. Oelze*, 208 Ariz. 591, 96 P.3d 1078 (Ct. App. Div. 1 2004)\* and *Diaz v. Bukey*, 125 Cal. Rptr. 3d 610 (Cal. App. 2d Dist. 2011), as modified on denial of reh'g, (June 8, 2011) and review granted and opinion superseded, 257 P.3d 1129 (Cal. 2011). In both *Schoneberger* and *Diaz*, the courts relied on the distinctions between a trust and a contract. Specifically, in *Schoneberger*, the court stated that the beneficiaries' "relationship with [the settlors and trustees] was not contractual 'as the creation of a trust is concerned with a conveyance of the beneficial interest in the trust property.'" *Schoneberger v. Oelze*, 208 Ariz. 591, 96 P.3d 1078, 1081 (Ct. App. Div. 1 2004).

The court stated that Texas, like Arizona and California, recognizes distinctions between the formation of a contract and the creation of a trust. Specifically, a contract must meet the requirements set forth above, whereas a trust is a method used to transfer property. The court stated that a trust refers to "the *fiduciary relationship* governing the trustee with respect to trust property." See *Huie v. DeShazo*, 922 S.W.2d 920 (Tex. 1996). Additionally, a trust can be created without the beneficiary's participation. **Tex. Prop. Code Ann. § 112.001**. Moreover, while the settlor must manifest and intent to create the trust, he or she does not need to receive consideration for doing so. **Tex. Prop. Code Ann. §§ 112.002 and 112.003**.

Accordingly, the court concluded that the arbitration provision was not enforceable as a contract and affirmed the trial court's order denying the motion to compel arbitration.

\*Caution: The court's ruling in *Schoneberger v. Oelze*, 208 Ariz. 591, 96 P.3d 1078 (Ct. App. Div. 1 2004) was superseded by statute. Ariz. Rev. Stat. Ann. § 14-10205 which provides that "[a] trust instrument may provide mandatory, exclusive and reasonable procedures to resolve issues between the trustee and interested persons or among interested persons with regard to the administration or distribution of the trust."