

USING AN ASSET PROTECTION TRUST FOR MEDICAID PLANNING IN 2011

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Q: Mr. Anderson, what is a Medicaid Asset Protection Trust and how is it used for Medicaid planning and why is it better than outright gifts?

A: A Medicaid Asset Protection Trust is a Trust established by a senior to protect assets from being spent down if a nursing home admission occurs. The assets held in such a Trust will be exempt from Medicaid spend down after a waiting period.

In an Asset Protection Trust, the Medicaid applicant is neither named as Beneficiary, nor as a Trustee. As a result, the assets in the Trust do not belong to the Medicaid applicant and are not countable under the Medicaid rules.

In most cases the Trust will be irrevocable which means that the senior trust maker gives up control of the assets in the Trust but can retain income rights. The primary beneficiaries of the Trust are the heirs or other loved ones of the future Medicaid applicant, but they do not receive the assets until after the death of the Medicaid recipient.

Application of the 60-month Period. The transfer of assets into the Trust will trigger a Medicaid look-back period of 60-months in both Michigan and Wisconsin.

The right to change your mind. In the Trust, the senior Trust Maker retains the right to change his/her mind as to who the ultimate beneficiaries. This power is called a *special or limited power of appointment*.

Outright Gifting Compared. An alternative to the Asset Protection Trust is for the Medicaid applicant to make outright gifts which are owned by the beneficiary without restrictions. Outright gifts can have serious consequences. The gifted assets can immediately be spent by the recipient, may be partially lost in a divorce, are exposed to the beneficiary's creditors, and will lose the important stepped-up tax basis advantage (discussed below). The use of an Asset Protection Trust will help avoid these family and tax concerns.



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Gift Tax Reporting. No gift tax is due because the Trust contains a retained power for the trust maker to change the ultimate beneficiaries IRS Reg. §25.2511-2(b).

Income Tax Reporting. In a Medicaid Asset Protection Trust, the senior trust maker who establishes the Trust, is called the Settlor (or Grantor). A trusted family member or friend is named as the Trustee.

In most cases, the trust maker will want to continue to be taxed on the income from assets, whether interest dividends or capital gains rather than to push the income-tax paying duty to the beneficiaries or the Trust. This can easily be achieved by setting up the Trust as a *Grantor Trust* for income tax purpose. *Grantor Trust* status is achieved by giving the trust maker the powers to trade assets of equal value and to add beneficiaries. See Sections 675(c)(4) and 674 of the Internal Revenue Code.

As a result, the compressed income tax brackets of a trust are easily avoided since the trust is considered as a pass-through entity. IRS Treas. Reg. 1.6714(a) requires that trust income is reported on a separate informational statement attached to Form 1041. Your tax preparer will continue to report all dividend and interest income from assets on Schedule B and all capital gains on Schedule D of your Form 1040.

The Stepped-up Tax Basis Advantage. When a decedent passes away, the person who inherits capital assets from the decedent may be entitled to receive an income-tax free inheritance, allowing them to sell these assets without tax on the pre-death capital gain. Capital assets include real property, stocks, and mutual funds. This important tax advantage is achieved under Internal Revenue Code § 1014 by providing a stepped-up tax basis, from the decedent's low original cost basis to the asset's fair market value at the time of death. The retained special power of appointment mentioned earlier also works to trigger the stepped-up tax basis under IRC §2036 and §2038.



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Outright gifts of capital assets will lose the stepped-up tax basis because the decedent's original cost basis carries over to the recipient.

The Best Time to Use Medicaid Asset Protection Trust. Keep in mind that assets placed into an Asset Protection Trust are no longer controlled by the former owner. When a person is healthy or wants to retain control, or has no one they can trust to whom control can be entrusted, an Asset Protection Trust is not recommended.

Note: In Michigan , a deed into such a Trust may trigger an uncapping of the freeze on the assessment unless it contains special provisions.

For an appointment to explore Medicaid planning issues, please call the Elder Law Firm of Anderson Associates, P.C. at (906) 228-6212, visit our website at www.upelderlaw.com or email us at rcanderson@upelderlaw.com You may also contact us at 148 W. Hewitt, Marquette, MI 49855

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