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# Drafting Irrevocable Trusts to Preserve Medicaid and VA Benefits

Selecting Trust Type, Protecting Assets, and Optimizing Tax Planning for Long-Term Care

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THURSDAY, MARCH 10, 2022

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# Drafting Irrevocable Trusts to Preserve Medicaid & VA Benefits



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# Overview of the VA Aid and Attendance Benefit

- When talking about VA Benefits for the purposes of this CLE, we are referencing the Non-Service Connected Pension Benefit, commonly known as Aid and Attendance.
- This benefit does not require that the veteran have a service-connected disability or injury.
- This pension is available to a veteran, surviving spouse or dependent child.



# What is the Aid and Attendance Benefit?

- Improved Pension – a base level benefit for those with low income.
- Allowances on top of benefit:
- Housebound – for purposes of employment
- Aid and Attendance – needing assistance with 2 or more activities of daily living (ADL's)

# What is the Aid and Attendance Benefit?

- 2022 Maximum Allowable Pension Rates (**MAPR**) for Aid and Attendance:
  - Married Veteran - \$2,431
  - Single Veteran – \$2,050
  - Surviving Spouse – \$1,318

# A&A Eligibility Requirements

## 3 Part Qualification Process:

- Service Requirement
- Disability Requirement
- Means Test – Income and Asset Requirements
  - This includes the lookback period for transfers.

# A&A Eligibility: Service Requirement

- The veteran must have 90 days of consecutive active-duty service.
- At least one of those 90 days served during a “period of conflict” (although the veteran does not have to have been in combat).
- Received a discharge that wasn’t dishonorable.



# A&A Eligibility: Service Requirement

## Dates of Wartime:

- World War II – December 7, 1941 through December 31, 1946, extended to July 25, 1947, when continuous with active duty on or before December 31, 1946
- Korean War – July 27, 1950 through January 31, 1955
- Vietnam War – August 5, 1964 – May 7, 1975, and \*February 28, 1961 – May 7, 1975 (for those who were in Vietnam)
- Persian Gulf War – August 2, 1990 to date yet to be determined

# A&A Eligibility: Disability Requirements

- Claimant must be 65 or older, or be permanently and totally disabled. See 38 USC § 1513(a), 38 CFR § 3.317(b)(2); 3.321(b)(2); 3.340; and 3.342
- Must show that have a medical need.
- Person must need assistance with two or more activities of daily living.



# A&A Eligibility: Means Test – Asset Requirements

- On October 28, 2018, the new VA regulations went into effect.
- Asset limit is now \$138,489 (as of 2022)
- Income that exceeds UME's is countable as an asset.
- Lot size for home reduced to 2 acres.
- Assets are now subject to a transfer penalty.



# A&A Eligibility: Means Test – Asset Requirements

- Lookback period for asset transfers is 3 years.
  - Does not include transfers prior to 10/18/18
- Transfers penalized at the MAPR for a married veteran.
- Only assets over the max asset limit will be penalized.
- Annuity purchases now penalized.
- 5 year max penalty period.



# A&A Eligibility: Means Test – Asset Requirements

- To eliminate penalty, assets must be returned to the claimant before the date of the claim or within 60 days of the VA notifying the claimant of the penalty period.
- Evidence must be received by the VA not later than 90 days after the notice of decision.

# Intro to VA and Medicaid Trusts

- The trusts we discuss today are self-settled irrevocable asset protection trusts.
- Typically, these trusts will contain provisions that allow for grantor trust treatment.
- The Grantor may or may not reserve a right to the income from the trust, depending on whether VA benefits are available and/or depending on how the Grantor wishes for the income to be treated when planning for Medicaid.



# Medicaid and Irrevocable Trusts

- Irrevocable Trusts for Medicaid are also permitted under the CMS Medicaid Manual:
- 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, the following rules apply to that portion... the 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.

# VA and Irrevocable Trusts

- The guidance we have for VA benefits and irrevocable trust planning comes from general counsel opinions, such as 72-90, 73-91, and 33-97. These opinions are included in your Appendix.
- The guideline for VA irrevocable trust planning is that trust assets will be countable unless claimant relinquishes "all rights of ownership" and "the right of control of the property." 38 C.F.R § 3.276 (b)

# Common Trust Challenges and Practical Tips



# Trust Income and Medicaid

- Income:
  - For Medicaid purposes, a Grantor may retain the right to receive income from the trust.
  - If the Grantor has a right to the income, then that income will be countable income for Medicaid purposes.
  - If the Grantor retains an income right, that income may make them ineligible for certain Medicaid benefits in the future.
  - Consider this carefully if your state has a Medicaid home care or assisted living waiver program or if your client's income is close to the average private pay rate at the nursing homes in your area.

# Trust Income and Medicaid

- Consider also that if the Grantor needs nursing home care in the future, the income from the trust will be counted towards his patient pay requirement and will be paid to the nursing home.
- If the Grantor retains the right to the income from the trust, and the trustee terminates the trust or otherwise invests the trust assets so that there is limited to no income for the Grantor once the Grantor needs Medicaid services, Medicaid may deem that to be an uncompensated transfer.
- Many practitioners recommend against having the Grantor retain an income right. But it can be viewed on a client-by-client basis.



# Trust Income and VA Benefits

- For VA purposes, the Grantor should not retain the right to receive income from the trust.
- Nor should the Grantor be taxed on the trust income, even if he does not receive that income.
- Although there is no precise VA regulation on this point, if the Grantor retains the right to the income, or is taxed on the trust income, then the entire corpus of the trust may be counted as an asset.



# Trust Principal and Medicaid

- For Medicaid purposes, the principal sum of a trust may be countable if the trust assets are “available” to the Grantor.



# Trust Principal and Medicaid

- The Key Test: Existence of Circumstances Under Which Distributions Could Be Made:
  - If there are any circumstances in which all or a portion of a trust can be made to the individual:
    - Payments of income from any portion are considered monthly income.
    - Any portion of the corpus that could be paid, under any circumstances to the individual, are available assets.
    - Any income or corpus paid to other individuals that could have been paid to the individual are deemed transfers of assets.
    - See 42 USC § 1396p(d)(3)(B); SMM § 3259.6.B.

# Trust Principal and Medicaid

- If there are NO circumstances in which distributions of corpus can be made to the individual; analyze for transfer of assets as of “the date the trust was established” or transfer to the individual was foreclosed.



# Trust Principal and VA Benefits

- For VA purposes, the lifetime beneficiary may not be living in the Grantor's household. The VA considers transfers to a person living in the Grantor's home as being disregarded and the VA will count the value of those assets as a resource for the claimant. Medicaid does not have this same requirement.
- If trust property is sold, the proceeds should remain in the trust or be paid to the lifetime beneficiaries. The trust proceeds should not be paid to the grantor upon sale of trust property.

# Trust Principal and VA Benefits

- The VA will count all funds in a Supplemental Needs Trust as an asset for the claimant (including self settled SNT and testamentary SNT) so these types of trusts should not be used for VA benefits eligibility planning.



# Trust Drafting Tips

## Residence Trust Planning:

- For the home only, a traditional Intentionally Defective Grantor Trust (IDGT) could work.
- However if home is sold, then proceeds may not stay in the IDGT because it would cause ineligibility for VA benefits due to the taxation of the investable assets.
- Proceeds must pay out to beneficiaries (not claimant) or be held in trust that is not defective for income tax purposes.



# Trust Drafting Tips

## Common Strategy using Two Irrevocable Trusts:

- Trust 1 holds the principal residence only.
- Trust 1 is an IDGT, no income to grantor, limited testamentary power of appointment for the step-up in basis.
- Upon sale of the home, proceeds are distributed out to beneficiaries or into the 2nd irrevocable trust.
- Trust 2 holds all other assets, mandatory payment of income to lifetime beneficiaries, limited testamentary power of appointment for the step-up in basis.

# Trust Drafting Tips

- Under the two trusts strategy, the two trusts may be combined into one instrument for ease of administration.
- The trust should name a Trustee and a Lifetime Beneficiary or Beneficiaries.
- The Lifetime Beneficiary is the beneficiary of the trust income and principal while the grantor is living, will be taxed on the trust income and may remove trust principal according to the terms of the trust.



# Trust Protector or Advisor

- Given the uncertainties of the law, it may be advisable to appoint a Trust Protector or Advisor. A Trust Advisor is an individual to whom the trust has granted any number of discretionary powers. With proper planning, appointing a trust advisor can add a level of flexibility to the trust.
- Trust Advisors may be used to amend or terminate the trust, select successor trustees, and direct distributions. Take care to select a trust advisor who is not a subordinate or related party to avoid the allegation that the appointment of the trust advisor is a sham to allow the grantor to remain in control. Note also that state trust law concerning the use of trust advisors varies and should carefully be consulted, especially regarding when the trust advisor may be deemed to be acting in a fiduciary capacity.
- Neither the Grantor nor the Trustee should act as the trust advisor.

# Rules for Who May Serve as Trustee

- For Medicaid purposes, many practitioners recommend that the Grantor not serve as Trustee. Although there is no specific guidance on this in the federal Medicaid regulations, some states may determine that if the Grantor serves as Trustee, then the assets are an available resource. A conservative approach would be to not allow the Grantor to serve as Trustee. Evaluate based on your state's regulations.



# Rules for Who May Serve as Trustee

- VA regulations state that the claimant must relinquish "all rights of ownership" and "the right of control of the property."
- VAOPGCPREC 73-91 states: 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.

# Rules for Who May Serve as Trustee

- Although this opinion would appear to allow a Grantor to serve as Trustee, there has not been a more recent and specific General Counsel opinion directly on point.
- Allowing a Grantor to serve as Trustee could be construed by the VA as the grantor retaining control of the trust assets in some manner.
- Therefore, for VA benefits purposes, consider appointing an individual other than the Grantor to serve as Trustee.



# Grantor Provisions and Trustee Powers that Must be Prohibited

- Avoid the Grantor retaining the power to revoke or amend the trust. This creates a revocable trust. All assets in a revocable trust will be countable for Medicaid and VA purposes.



# Grantor Provisions and Trustee Powers that Must be Prohibited

- Eliminate the right for the Trustee to terminate a small trust, or if allowing the right to terminate, ensure that Grantor is not in the class of beneficiaries who would receive trust assets if the trust was terminated.
- Lock the discretion to determine income and principal.
- Avoid special powers of appointment and use testamentary powers of appointment instead.
- Consider using a separate tenancy, occupancy agreement or lease agreement to allow the Grantor the right to remain in the home instead of an implicit right inside the trust.
- Don't discuss the trust being used for the Grantor's future needs.

# Grantor Provisions and Trustee Powers that Must be Prohibited

- Trustee should not have the power to adjust between income and principal (if the Grantor retains an income right to the trust.) Doing so may cause Medicaid to deem the principal as a countable resource.
- Consider whether using property substitution to achieve grantor status could cause trust property to be considered as a resource for Medicaid or VA purposes.
- Avoid allowing the Grantor to remove and replace trustees as this could cause trust property to be considered as a resource for Medicaid or VA purposes.



# Thank You For Attending!



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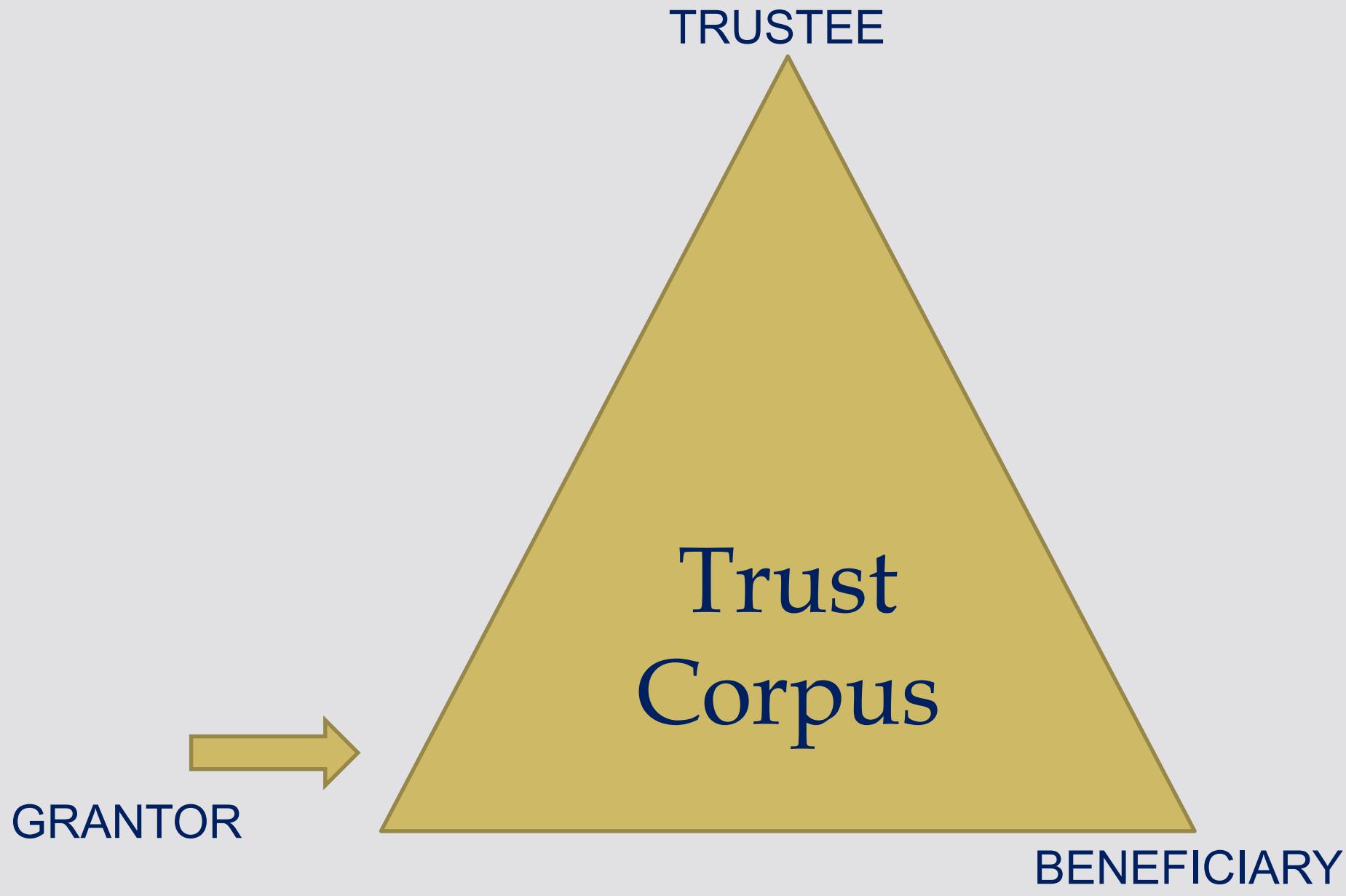
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# Introduction

Special thanks is due Brian Albee and the entire Elder Counsel team for their invaluable contributions to certain portions of this presentation.

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# FIDUCIARY DUTY

A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a trustee) to the beneficiary; a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person.

# TRUST PROTECTOR

A person or corporation that, depending on the terms of the trust, has authority to oversee the trustees, to change provisions of the trust, to veto acts of the trustees, and, in general, to ensure that the trust is being properly administered.

# Income-Only Irrevocable Trust

## Income Only Trusts

Irrevocable Income-Only Trust authorized by 42 USC § 1396p(d)(3)(B)

- i. income to grantor but no principal
- ii. may be drafted as an intentionally defective grantor trust

# **Irrevocable Trusts**

## **Irrevocability Provision**

This trust is irrevocable, and neither of us may alter, amend, revoke, or terminate it in any way.

# **Irrevocable Trusts**

## **Income Provision**

Our Trustee must pay, at least annually, all of the net income from the trust property, after deducting all expenses associated with the trust property, to or for our benefit.

# **Irrevocable Trusts**

## **Restriction of Principal**

Our Trustee shall have no right, power, privilege, or authority to invade or distribute principal of the trust to or for the benefit of either of us, under any circumstances.

# Individual Income Tax Rates 2021

Taxable Income	Marginal Tax Rate
Not over \$9,950	10%
Over \$9,950 but not over \$40,250	12%
Over \$40,250 but not over \$86,375	22%
Over \$86,375 but not over \$164,925	24%
Over \$164,925 but not over \$209,425	32%
Over \$209,425 but not over \$523,600	35%
Over \$523,600	37%

# Estate and Trust Income Tax Rates 2021

Taxable Income	Marginal Tax Rate
Not over \$2,650	10%
Over \$2,650 but not over \$9,550	24%
Over \$9,550 but not over \$13,050	35%
Over \$13,050	37%

# Traditional Grantor Trust Planning

One successfully achieves grantor trust status while removing the assets from his or her estate for estate tax purposes if:

The trust includes a power exercisable in a nonfiduciary capacity to reacquire the assets by substituting assets of equivalent value, without the approval or consent of any person in a fiduciary capacity;

IRC § 674 (4)(c) and Treas. Reg. § 1.675-1(b)(4)(iii).

The trust includes a power to add the class of beneficiaries (other than to provide for after-born or after-adopted children), including, without limitation, a charitable beneficiary; or

IRC § 674(a).

The trust includes a power to enable the grantor to borrow money or assets from the trust without adequate interest or security.

IRC § 675.

# Powers to Control Beneficial Enjoyment

General Rule. Code §674(a) provides that a grantor shall be treated as the owner of any portion of a trust in respect of which 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.

# Power to Dispose of Beneficial Enjoyment

- Treas. Reg. §1.674(a)-1(a) provides that any power that can “affect the beneficial enjoyment of a portion of a trust” is a power to dispose of beneficial enjoyment, *regardless of the capacity in which the power is held.*
- Based on this general rule alone, many discretionary trusts would be treated as grantor trusts.

# Powers to Affect Beneficial Enjoyment

The powers described below can be exercised by any person without causing a trust to be a grantor trust status.

- Power to apply income in support of a dependent.
- Postponed power to affect beneficial enjoyment.
- Power exercised only by Will. (Code 674)(b)(3).
- Power to distribute principal. (Code §674(b)(5)).
- Power to withhold income temporarily.
- Power to withhold income during disability of beneficiary. (Code §674(b)(7)).
- Power to allocate between income and corpus (code §674(b)(8)).

Code § 674: Power to Control Beneficial Enjoyment

# Power Exercisable only by Will

Code§674(b)(3) provides that a power exercisable solely by Will generally does not cause a trust to be owned by its grantor.

Example:

- A trust instrument provides that trust income is to be accumulated during the life of the grantor's spouse, who may appoint the trust income by Will, without the consent of an adverse party.

# Power to Distribute Principal

Grantor trust status will not be triggered as a result of a power to distribute corpus to trust beneficiaries that is limited by a reasonably definite standard or a power to distribute corpus to current income beneficiaries.

# Power to Distribute Corpus is Limited

## Reasonably Definite Standard

For instance a power to distribute corpus for the education, support, maintenance, or health of the beneficiary; for his reasonable support and comfort; or to enable him to maintain his accustomed standard of living; or to meet an emergency, would be limited by a reasonably definite standard. However, a power to distribute corpus for the pleasure, desire, or happiness of a beneficiary is not limited by a reasonably definite standard..."

# Administrative Powers

Overview/Purpose:

Code §675 treats a grantor as owner of any portion of a trust if administrative control of the trust is exercisable primarily for the benefit of the grantor rather than for the beneficiaries of the trust.

# General Powers of Administration

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interest of the beneficiaries.

## Power to Control Trust Investments:

A grantor will be treated as owner of any portion of a trust over which any person has a power, to control the investment of the trust fund either by directing the investments or reinvestments.

## Power to Reacquire Trust Assets:

A power to reacquire trust corpus by substituting property of equivalent value will result in grantor trust status.

# Viable Choices for Causing Grantor Trust

1. A power exercisable in a nonfiduciary capacity to reacquire the assets by substituting assets of equivalent value, without the approval or consent of any person in a fiduciary capacity (IRC § 674 (4)(c) and Treas. Reg. § 1.675-1(b)(4)(iii))
2. A power to add a class of beneficiaries such as one or more charities (IRC § 674(a))

# Power Exercisable only by Will

Code§674(b)(3) provides that a power exercisable solely by Will generally does not cause a trust to be owned by its grantor. If, however, the power of appointment governs income and principal, the trust will be a grantor trust.

Example:

- A trust instrument provides that trust income is to be accumulated during the life of the grantor's spouse, who may appoint the trust income by Will, without the consent of an adverse party.

Code § 674: Power to Control Beneficial Enjoyment

# Testamentary GPOA vs. LPOA

GPOA- General Power of Appointment.

LPOA- Limited Power of Appointment

So long as a grantor's power to appoint trust property does not include a power to appoint income, the power would not seem to trigger grantor trust status under Code §674(b)(3). However, it is possible that a grantor's power to appoint trust property to his or her estate, his or her creditors or the creditors of his or her estate could be viewed as a Code §673 reversionary interest that would make the trust a grantor trust.

Code § 674: Power to Control Beneficial Enjoyment

# **Irrevocable Trusts**

## **Limited Power of Appointment**

I have the limited testamentary power to appoint the remaining principal and accrued or accumulated income of the trust to or for the benefit of any one or more of my descendants or any charities of my choosing. I may not exercise this power of appointment for the benefit of either of myself, my creditors, my estate, or the creditors of either of my estate.

# Tax Legislation in 2010

- The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (TRUIRJCA) of 2010, signed into law by President Obama on December 17, 2010, was a two-year reprieve from the sunset provisions of EGTRRA, which would have returned the tax provisions to 2001 levels.
- EGTRRA was designed to sunset on January 1, 2011. Although the estate tax was repealed for one year in 2010 under EGTRRA, due to the sunset provision, the estate tax exemption would have reverted to \$675,000 at a 55 percent top rate, as it was in 2001. TRUIRJCA stopped the reversion and set the estate tax exclusion at \$5 million at a 35 percent top rate for two years.
- TRUIRJCA also introduced the concept of “portability” of the federal estate tax exemption between married couples for the 2011 and 2012 tax years.

# **Tax Cuts and Jobs Act**

- Current law increased the estate, gift, and generation-skipping transfer (GST) tax exemption from a base of \$5 million (set in 2011) to a base of \$10 million
- The estate, gift, and GST tax rate is 40 percent.
- The exemption amount is adjusted for inflation annually and is currently \$11,700,000 for 2021.
  - A married couple effectively has \$23,400,000 in a combined estate tax exemption with proper planning.
- This higher exemption amount is scheduled to decrease on January 1, 2026, to \$5 million (indexed for inflation) unless decreased sooner by Democratic reform.
- Joe Biden has said that the estate, gift, and GST tax exemption could be set as low as \$3.5 million per individual, while the exemption amount for gifts could be set as low as \$1 million
- The estate, gift, and GST tax rate could increase to the 45 to 65 percent range.

# Possible Tax Changes

## Scheduled change

- Reduction in the estate, gift, and GST exemptions to \$5 million in 2026

## Possible changes

- Reduction in estate and GST tax exemptions to \$3.5 million before 2026
- Lowered lifetime federal gift tax exemption to \$1 million before 2026
- Increased estate tax rates: In 2001, estate tax rates were as high 55 percent, with an additional 5 percent for estates over \$10 million
- Increased rate on capital gains or treatment as ordinary income

# **Anti-Clawback Regulations**

## **Tax Cuts and Jobs Act**

- The Internal Revenue Service (IRS) finalized regulations on the anti-clawback rules.
  - The anti-clawback rules provide that a decedent will not be treated as having made taxable transfers in excess of the decedent's applicable exclusion amount at the time of the decedent's death if:
    - the decedent uses the increased estate, gift, and GST tax exclusion amounts while the Tax Cuts and Jobs Act is in effect and
    - dies after the amounts are potentially reduced.
- By transferring assets now, your clients can protect up to \$11,700,000 (for an individual) or \$23,400,000 (for a married couple) in assets from estate, gift, and GST tax.

# Anti-Clawback Rules

- What to do if there is difference between the basic exclusion amount that was applicable on the date of a donor's gift and the basic exclusion amount that is applicable on the date of death.
  - If the total amount allowable as a credit in computing the gift tax on the decedent's gifts is greater than the credit that is allowable in computing the estate tax on the decedent's taxable estate, then the portion of the credit used in computing the estate tax is the sum of the basic exclusion amount that used as a credit in computing the gift tax
  - Treas. Reg. § 20.2010-1(c)(1)

# Anti-Clawback Rules

Individual A (never married) made cumulative taxable gifts of \$9 million, all of which were sheltered from gift tax by the cumulative total of \$11.7 million in basic exclusion amount.

The basic exclusion amount on A's date of death is \$6.8 million. A was not eligible for any restored exclusion amount pursuant to Notice 2017- 15.

Because the total of the amounts allowable as a credit in computing the gift tax payable on A's gifts (based on the \$9 million of basic exclusion amount used to determine those credits) exceeds the credit based on the \$6.8 million basic exclusion amount allowable on A's date of death, the credit for purposes of computing A's estate tax is based on a basic exclusion amount of \$9 million.

Treas. Reg. § 20.2010-1(c)(2)(i) Example 1

# Anti-Clawback Rules

- Individual B's predeceased spouse, C, died before 2026, at a time when the basic exclusion amount was \$11.7 million. C had made no taxable gifts and had no taxable estate. C's executor elected to allow B to take into account C's \$11.7 million DSUE amount.
- B made no taxable gifts and did not remarry. The basic exclusion amount on B's date of death is \$6.8 million.
- The credit to be applied for purposes of computing B's estate tax is based on B's \$18.5 million applicable exclusion amount, consisting of the \$6.8 million basic exclusion amount on B's date of death plus the \$11.7 million DSUE amount.
  - Treas. Reg. § 20.2010-1(c)(2)(iii) Example 3
  - DSUE applied before BEA is applied to gifts

# Gifting Intent Language

- I specifically intend that:
  - any transfers made to this trust be treated as a completed gift for federal estate and gift tax purposes and
  - the assets of the trust estate be excluded for federal estate tax purposes from my gross estate.

# **WHEN ARE TRANSFERS TO IRREVOCABLE TRUSTS COMPLETED GIFTS?**

# Introduction

## Why Should I Care About This?!

- Helps You Explain a Benefit of Irrevocable Trust Planning!

# Scenario

## Example:

- Assume Mary wishes to do some asset protection planning with your firm.
- Mary's assets are as follows:
  - 1 house valued at \$200,000.00 that she bought forty years ago for \$65,000.00.
  - 50 acres of farmland currently valued at \$150,000 that she inherited from her uncle 35 years ago (The value of the land at the uncles date of death is unknown.)
  - 3 certificates of deposit totaling \$30,000.00
  - 1 checking account with a balance of \$2,100.00

# Scenario

## □ Planning Scenario 1

- Mary decides to give each of her two children undivided interests in her home and farm.
- To execute the gifts, Mary has an attorney prepare and file four gift deeds.

## □ Planning Scenario 2

- Based upon your advice, Mary puts her home, farm, and \$10,000 cash inside an irrevocable trust to which she retains a right to income and a limited testamentary power of appoint over the entire trust corpus and any undistributed income.

# Scenario

- ❑ Legal fees and costs of Scenario 1: \$750.00
- ❑ Legal fees and costs of Scenario 2: \$15,000.00

# Scenario

72 months after either scenario, assume Mary enters a skilled nursing facility, quickly qualifies for Medicaid, and stays in that skilled nursing facility until her death 30 months later.

# Scenario

- ❑ Under either scenario, Mary's assets won't be counted as available resources for purposes of Medicaid qualification nor will those assets be subject to estate recovery.
- ❑ Further assume, however, that Mary's children want to liquidate, at her death, the assets Mary gave to them (the house and farm) and distribute the net proceeds equally to each surviving child.

# Scenario

- Tax Consequences of Planning Scenario 1
  - The federal capital gains tax resulting from the sale of the house and farm could be over \$60,000.00
- Tax Consequences of Planning Scenario 2
  - The federal capital gains tax resulting from the sale of the house and farm would, in most circumstances, be \$0.00!

# Scenario

- Tax Consequences of Planning Scenario 1
  - Assume each of Mary's children have AGI of \$200,000.00 (exclusive of the \$285,000.00 long-term capital gain).
  - The additional tax resulting from the long-term capital gain of \$285,000.00 is about \$29,000.00 per child.
  - Note: If each of Mary's children have AGI of \$100,000.00 (exclusive of the \$285,000.00 long-term capital gain), the additional tax is approximately \$23,000.00 per child.

# Scenario

## □ Tax Consequences of Planning Scenario 2

- Assume each of Mary's children have AGI of \$200,000.00 (exclusive of the \$285,000.00 long-term capital gain).
- Additional capital gains tax would be \$0.00 because the basis would equal the sales price of the real estate; therefore, no long-term capital gain.

# **Gift Taxes and Estate Inclusion**

- ❑ The gift tax only applies to “completed” gifts

# **Gift Taxes, Powers, and Estate Inclusion**

- Gift Taxes
  - Definition of “gift”
    - 2512(b): Property transferred for less than adequate and full consideration is deemed a gift
    - 25.2511-1(c)(1): An interest in property gratuitously conferred upon another constitutes a gift

# **Gift Taxes, Powers, and Estate Inclusion**

- Treas. Reg. § 25.2511-2(b) Definition of Completed Gift
  - “As to any property . . . of which the donor has so parted with dominion and control as to leave in him no power to change its disposition . . . the gift is complete.”

# **Gift Taxes, Powers, and Estate Inclusion**

- Gift Taxes
  - Definition of “completed” gift
    - 25.2511-2(b) Example (part 1)
      - Income to donor or accumulated  
in discretion of trustee
      - + Retained testamentary LPOA
      - = Entire transfer is incomplete gift

# **Gift Taxes, Powers, and Estate Inclusion**

## Gift Taxes

- Definition of “completed” gift
  - 25.2511-2(b) Example (part 2)

Income to donor or accumulated in discretion of trustee	<u>+ No retained testamentary</u>	<u>LPOA</u>
= Entire transfer is completed gift		

# **Gift Taxes, Powers, and Estate Inclusion**

- Gift Taxes
  - Definition of “completed” gift
    - PLR 200247013 (aka PLR 124396-02)  

Income to donor or others or accumulated in  
discretion of distribution committee

      - + Discretionary principal to others for any  
purpose
      - + Retained testamentary LPOA

= Entire transfer is incomplete Gift

# **Gift Taxes, Powers, and Estate Inclusion**

- Powers (Retained Testamentary LPOA)
  - To get stepped-up basis
  - 1014(b)(9) – Property acquired from the decedent
  - 2038(a)(1) – Revocable Transfers

# **Gift Taxes, Powers, and Estate Inclusion**

- Powers (Retained testamentary LPOA)
  - 1014(b)(9) – Property acquired from the decedent
    - Property acquired from a decedent includes “property acquired from the decedent by reason of death . . . , if by reason thereof the property is required to be included in determining the value of the decedent’s gross estate . . . ”

# **Gift Taxes, Powers, and Estate Inclusion**

- Powers (Retained testamentary LPOA)
  - 2038(a)(1) – Revocable transfers
    - “The value of the gross estate shall include the value of all property . . . of which the decedent has at any time made a transfer . . . where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power by the decedent . . . to alter, amend, revoke, or terminate . . .”

# Possible Disclaimer

We assume that all tax returns (including, without limitation, gift tax returns necessitated by any estate planning you implement with our assistance) will be prepared by some other party and that you will notify that other party of the possible need to prepare such returns and will provide that other party with copies of documents we prepare. We do not have any compliance procedures to remind our clients of the need to file such returns.



Questions?

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