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Medicaid Planning: Pros and Cons of Gifting the House Under Current Tax Law

Eligibility Rules, Gift and Capital Gains Tax Implications, Trust Drafting Issues, and Gifting Alternatives

WEDNESDAY, JUNE 24, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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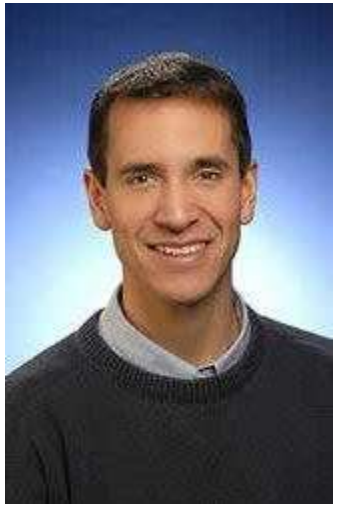
Medicaid Eligibility & Gifting Rules



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June 24, 2020

Warning

- Unlike Medicare & Social Security benefit programs, Medicaid is a federal program run by departments of state governments.
- States can differ signifcantly in how they manage the Medicaid program.
- The figures used (income limits, asset limits, penalty calculations, etc.) vary state-to-state, sometimes county-to-county or region-to-region.
- Please be mindful of this unique federal-state dynamic during today's presentation.

Medicaid Introduction

- Established in 1965, Title XIX “Title 19” of the SSI Program.
- The federal government sets minimum coverage standards, but states may expand their programs beyond the minimum requirements.
- Available to anyone who is disabled and has lowered their financial resources to a required level.
- SSI beneficiaries are automatically eligible for Medicaid in most states.
- Medicaid generally covers home-based community care as well as institutional care (nursing home).

Countable Assets

- The State sets a limit on "countable" resources. Generally, these are assets that are available to pay for the applicant's medical care.
- In most (if not all) states, joint accounts are generally considered 100% owned by the applicant, regardless of how many joint owners there are.
- Real estate solely owned by an applicant who no longer lives there may be considered countable even though it is illiquid.
- If the applicant is the beneficiary of a trust, then at least some of the trust assets (possibly all of the trust assets) may be generally countable. Tread carefully when incorporating trusts into your Medicaid planning.
- "Availability" is a key concept in Medicaid.

Non-Countable Assets

- A nursing home resident can keep very little in liquid assets (up to $2,000 in most SSI states).
- Healthy community spouse can keep ½ of the joint assets up to $128,640 with a “floor” of $25,728 (2020 figures).
- The home if occupied by a spouse, disabled/blind child or child under age 21, or if applicant plans to return home.
- Personal effects.
- One car for the healthy community spouse.
- Term life insurance.
- Cash value of life insurance IF the total face value of all policies is under $1,500.
- “Partnership Policy” long term care insurance payout equivalent.
- Certain annuities.
- Certain types of trusts.
- Retirement accounts in some states.

Income Treatment

- Generally, all of the applicant's income must go to the nursing home.
- The applicant can keep a small amount each month for their personal account at the nursing home.
- An allowance can be allocated to the community spouse if a need can be demonstrated.
- Some states have income caps, but the excess can go to a "D4B" or "Miller" trust.
- The income of the community spouse is ignored.

Gifting

- The applicant's finances are audited for the 5-year period leading up to the Medicaid application.
- Any transfers of assets out of the applicant's name that does not benefit the applicant or the healthy spouse is a "gift" and a disqualifying transfer.
- The size of the transfer/gift will determine the length of the period of ineligibility for Medicaid (the "penalty period").
- The penalty period begins to run once the applicant is otherwise eligible for Medicaid.
- Beware of clients' confusion with the gift tax exemption (currently $15,000).

Permitted Transfers

- To a spouse.
- To a disabled or blind child.
- To a trust for a disabled individual who is under age 65.
- The house may be transferred to (besides those above):

  - Child under age 21

  - Child who has lived in the house for 2 years prior to the applicant moving to a nursing home and provided care to keep the applicant out of the home during that time.

  - Sibling with an equity interest in the house and who has lived there for one year prior to applicant's nursing home placement.

Gift Tax

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Annual Exemption

26 USCA §2503

- **b) Exclusions from gifts.**--
- **(1) In general.**--In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year.

Inflation Adjustment

(2) Inflation adjustment.--In the case of gifts made in a calendar year after 1998, the $10,000 amount contained in paragraph (1) shall be increased by an amount equal to--

(A) $10,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Current Annual Exemption

- $15,000 per person per year.

26 USCA §1 Tax Table for 2020

Section 3.43

https://www.irs.gov/pub/irs-drop/rp-19-44.pdf

So, what does this mean??

Net Effect

Gifts to any person of less than $15,000 do not need to be reported through a gift tax return.

These gifts are not taxable and will not be counted against the donor's lifetime exclusion.

BUT …

Medicaid is not the IRS.

NO GIFTS ARE OKAY WITH MEDICAID

Bad Advice? Good Advice?

Many estate planners routinely advise clients to give the annual exclusion amount to family members as part of an estate plan.

This is good advice only IF there are sufficient assets/insurance to meet all long-term care needs and Medicaid will not be an issue for at least five years (three in California).

Estate Tax Exemption

§ 2010. Unified credit against estate tax

(a) General rule.--A credit of the applicable credit amount shall be allowed to the estate of every decedent against the tax imposed by section 2001.

Estate Tax Exemption

(2) Applicable exclusion amount.--For purposes of this subsection, the applicable exclusion amount is the sum of--

(A) the basic exclusion amount, and

(B) in the case of a surviving spouse, the deceased spouse's unused exclusion amount.

Estate Tax Exemption Amount

(3) Basic exclusion amount.--

(A) In general.--For purposes of this subsection, the basic exclusion amount is $5,000,000.

(B) Inflation adjustment.--In the case of any decedent dying in a calendar year after 2011, the dollar amount in subparagraph (A) shall be increased by an amount equal to--

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 2010" for "calendar year 2016" in subparagraph (A)(ii) thereof.

Estate Tax Exemption Amount

(C) Increase in basic exclusion amount

In the case of estates of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, subparagraph (A) shall be applied by substituting “$10,000,000” for “$5,000,000”.

Estate Tax Exemption Current Amount

$11,580,000 for an individual or $23,160,000 for a couple.

26 USCA § 1

2020 Tax Table Section 3.41 for persons dying in year 2020.

State Inheritance Taxes

While Federal Estate Tax might not be an issue, each state will have its own rules concerning inheritance taxes.

See your state for details.

Gift Tax Returns

Only required on taxable gifts (those over $15,000).

Many times gifts are made as part of a Medicaid or Long-term Care plan. Filing the return is simply more indication of a completed gift that can be provided to Medicaid to show the resources are no longer those of the applicant.

Capital Gains Tax

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Determining Tax Basis

Three most common ways basis in an asset can be established:

1. Purchasing the item;
   a. I buy land for $50,000. My basis is $50,000.
2. Being given the item;
   a. Get the Donor's basis
3. Inheriting the item
   a. Basis is value at Decedent's death

Basis in Purchased Property

26 USCA § 1012

§ 1012. Basis of property--cost

(a) In general.--The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses).

Basis in Purchased Property

Buy Property for $50,000.

Sell Property six years later for $100,000.

Basis is $50,000. Gain is $50,000

Basis can be increased due to improvements, etc.

Basis in Gifted Property

26 USCA § 1015

§ 1015. Basis of property acquired by gifts and transfers in trust

(a) Gifts after December 31, 1920.--If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value.

Basis in Gifted Property

Mom buys property for $50,000.

Gifts property to daughter.

Daughter sells property six years later for $100,000.

Basis is $50,000. Gain is $50,000.

Basis can be increased due to improvements, etc.

Basis in Inherited Property

26 USCA § 1014

§ 1014. Basis of property acquired from a decedent

(a) In general.--Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be--

(1) the fair market value of the property at the date of the decedent's death,

Basis in Inherited Property

(b) Property acquired from the decedent.--For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;

(2) Property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust;

Basis in Inherited Property

An alternate valuation can be elected by the Executor under section 2032 or 2032A to value property sold within six months of the decedent's death at the value sold OR if not sold during that time, at the value six months after death.

- Election must be made by the executor

Basis in Inherited Property

Mom buys property for $50,000.

Mom dies. Property is worth $85,000 at her death. Daughter inherits property.

Daughter sells property two years later for $100,000.

Basis is $85,000. Gain is $15,000.

Capital Gains Exclusion on Home

26 USCA § 121

§ 121. Exclusion of gain from sale of principal residence

(a) Exclusion.--Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

Capital Gains Exclusion on Home

(b) Limitations.--

(1) In general.--The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

(2) Special rules for joint returns.--In the case of a husband and wife who make a joint return for the taxable year of the sale or exchange of the property--

(A) $500,000 limitation for certain joint returns.--Paragraph (1) shall be applied by substituting "$500,000" for "$250,000" if.--

(i) either spouse meets the ownership requirements of subsection (a) with respect to such property;

(ii) both spouses meet the use requirements of subsection (a) with respect to such property; and

(iii) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

Capital Gains Exclusion on Home

Paragraph 3 limits the Exclusion to one sale or exchange every two years.

So…..

1) Must be owned and USED by the taxpayer as their principal residence for two of the five years proceeding the sale.
2) $250,000 of gain is excluded for an individual, $500,000 for a couple, filing jointly.
3) Only one exclusion can be used every two years. No house hopping.
4) Known as the 121 Exclusion.

Calculating Gain on Residence

Sales Price

Minus Basis (purchase price, donor's basis, or value at date of death of decedent from which it was inherited PLUS cost of all improvements made while under taxpayer's ownership)

Minus capital gains exclusion amount (if all conditions satisfied)

Calculating Gain on Residence

$525,000 (Sales Price; sold by unmarried resident)

Minus $100,000 (Purchase price 30 years prior; no improvements made)

Minus $250,000 (121 Exclusion for single individual)

Capital Gain is $175,000.

Gain on Gifted Residence

Same example as last slide, but Mom gifts home to daughter before selling.

$525,000 (Sales Price; sold by unmarried resident)

Minus $100,000 (Purchase price 30 years prior; no improvements made)

No $250,000 exclusion because daughter is owner and she did not live in home for 2 of last 5 years.

Capital Gain is $425,000.

Calculating Tax Owed

If the daughter held the property for less than 1 year before selling, she will pay taxes on the gain ($425,000) at her ordinary income tax rate

If she held it for more than 1 year, she will pay the long-term capital gains tax rate, generally 0% 15% or 20%.

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Outright Gift?

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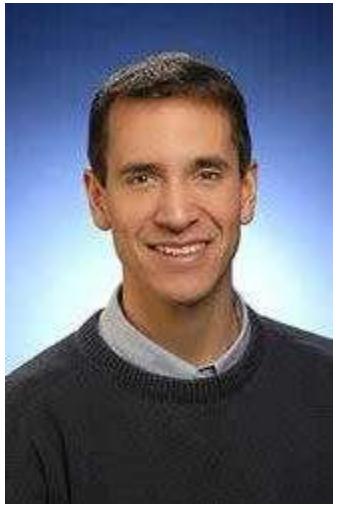

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A Clean Break

- When the client retains absolutely no ownership interest in the property and title is conveyed outright to the children.
- No life estate retained, no joint ownership, etc.
- Client's name no longer appears on the title to the house.
- If the client wants to continue to live in the house, then the client becomes the "tenant" and the children are the "landlords". A written lease agreement is advisable.
- Medicaid's 5-year look-back clock is started upon the transfer.

Pros to an Outright Gift

- Avoid the expense and administrative headaches of administering a trust.
- Assuming that the 5-year look-back for Medicaid is not a problem, there is no way for the State to treat any portion of the house as an “available” or “countable” asset of the client.
- Children will not be forced to convert the house to rental property, which may be a concern if life estate is retained.
- Probate avoidance.
- Client’s creditors cannot place a lien on the house (assuming no fraudulent conveyance).
- Client can still enjoy protection by executing a house lease and acquiring tenants’ rights.

Cons to an Outright Gift

- The client must file a gift tax return with State and/or IRS.
- Some municipalities offer tax credits for elderly and/or veteran homeowners, which could be lost.
- Eviction concerns if there is a falling-out with the children (a written lease agreement could mitigate this problem).
- Possible capital gains tax liability upon the children's eventual sale of the house.
- Children's creditors could place a lien on the house.
- The house could become part of a divorce settlement if children develop marital issues.
- Reverse mortgage is no longer an option.

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Transfers to Trusts

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Presentation for
Strafford Webinars
June 24, 2020

Pros

With proper drafting, you can:

- avoid the capital gains issues of outright gifting upon the grantor's death
- preserve the grantor's 121 exemption in the primary residence
- minimize the risk of the beneficiaries' creditors gaining access to the assets
- arrange for the most advantageous treatment of income

Cons

- Hard for clients to understand
- Inflexible
- Difficult to explain to Medicaid
- Must get 5 years after transfer of assets to the trust for them to be fully protected
- If doing a gift and return, some states may not recognize returns to grantor from trust beneficiaries

Trust Drafting Requirements

Overview

- Irrevocable
- For the corpus to be exempt, grantor may not receive distribution of principal under any circumstances
- Generally should not have grantor (or spouse) be trustee

Trust Drafting Requirements

42 USC 1396p(d)(3)

- B (ii) any portion of the 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 (c) of this section, and the value of the trust shall be determined for purposes of such subsection by including the amount of any payments made from such portion of the trust after such date.

Trust Drafting Suggestions

- Spendthrift Provision
- Maintaining 121 exclusion
  - Grantor trust provisions –See IRC Sections 671-678. Many attorneys use:
    - Power to substitute assets of equivalent value - IRC 675(4)(C) General Powers of Administration. May be held by the trust protector or nonadverse individual;
    - and/or power to add charitable beneficiaries - IRC 674(b)(5). May be held by grantor, trust protector or other nonadverse individual
      - Some have expressed concern that this will be too much control in grantor if grantor retains

Trust Drafting Suggestions

- Step-up in basis upon grantor's death - Retained limited testamentary power of appointment by the grantor
  - IRC 2038(a)(1) - The value of the gross estate shall include the value of all property— To the extent of any interest therein of which the decedent has at any time made a transfer (except … a … sale for … full consideration), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person … .

Trust Drafting Suggestions

- Lifetime occupancy clause – to maintain homestead exemption. BUT Medicaid may treat as a life estate in expanded probate states.
- Consider separate occupancy agreement. May not maintain homestead exemption but will keep trustees from evicting grantor.

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Life Estates

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Presentation for
Strafford Webinars

Preliminary Note

- There are 2 different types of life estates in Medicaid planning:
  - Retained life estate in own property
  - Purchased life estate in another's property
- Since we are talking about the client's own home today, we will deal with only the first type

Historically

- Common estate planning tool
- Example: Mom deeds her home to her daughter and retains a life estate in it.
- Benefits: Mom can live in the home the rest of her life; Mom still gets the homestead exemption; daughter gets step-up in basis at Mom's death (IRC 2036)

Medicaid Implications of Retained Life Estate

- May not be a problem for eligibility because state law may exempt

- But may be a problem at Medicaid recipient's death
  - OBRA 1993 allowed states to seek payback from a life estate owned by a Medicaid recipient – expanded estate recovery

Statutory Language

42 U.S.C. 1396p(b)(4)

For purposes of this subsection, the term “estate”, [sic] with respect to a deceased individual—

(A) shall include [probate assets]; and

Statutory Language – 42 U.S.C. 1396(p)(b)(4)

(B) may include, at the option of the State … , any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including such assets conveyed to a survivor, heir, or assign of the deceased individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.

States that Have Expanded Estate Recovery (may or may not include life estates) (from elderlawanswers.com)

Connecticut

- Georgia
- Hawaii
- Idaho
- Indiana
- Iowa
- Kansas
- Kentucky
- Maine
- Minnesota
- Mississippi
- Montana
- Nevada
- New Hampshire
- New Jersey
- North Dakota
- Ohio
- Oregon
- Pennsylvania
- Utah
- Virginia
- Washington
- Wisconsin
- Wyoming

Case Examples

In re Estate of Laughead, 696 N.W.2d 312, 316–17 (Iowa 2005) – Medicaid can recover from life estate of property once owned in fee title by recipient after recipient's death

In re Estate of Peterson, 157 Idaho 827 (Idaho 2014) – where conveyed remainder and got Medicaid within look-back period, life estate was part of estate (as was remainder).

Adm'r, State Medicaid Estate Recovery Program v. Miracle, 31 N.E.3d 658 (Ct. App. Ohio, 4th Dist. 2015) – Ohio could recover from recipient's life estate interest in W.V. property. (Note: suit was against heirs b/c no probate estate)

Likely not many reported cases because statute is explicit

Valuing Life Estate

- This is state-specific
- Generally, Medicaid may look to the value at the moment just before death, based on the person's age/life expectancy
- KY Example: Medicaid recipient at age 81 died owning a life estate in her prior home. Under Kentucky Medicaid's life estate table, her interest was valued at approximately 42% of the property value. So if the property was worth $100,000, her interest was $42,000, and that is what Medicaid may seek from the estate.

Where Life Estate is Not Subject to Estate Recovery

- In states that are limited to the probate estate, or that do not include life estates among the non-probate assets for recovery, life estates may still be used for planning
- Some states exempt life estates at eligibility stage
- In that case, retaining a life estate would be OK because it would not effect eligibility or be subject to estate recovery
- Transfer of the remainder would be subject to the 5-year look-back

Valuing Life Estate During Life

- Transfer of Life Estate before death:
  - An interest in a life estate can be transferred like any other asset
  - If not transferred for fair market value, it will be a disqualifying transfer with a penalty issued if application is within 5 years and if transfer was not exempt
- Look to Medicaid's life estate tables to see value of interest. See State Medicaid Manual, Publication 45, 3258.9A, citing 26 CFR 20.2031-7, which references table in 26 CFR 20.2031-7A . See also POMS SI 01140.120.

Valuing Life Estate During Life

Age	Life Estate	Remainder
70	0.60522	0.39478
71	0.58914	0.41086
72	0.57261	0.42739
73	0.55571	0.44429
74	0.53862	0.46138
75	0.52149	0.47851
76	0.50441	0.49559
77	0.48742	0.51258
78	0.47049	0.52951
79	0.45357	0.54643
80	0.43659	0.56341

Age	Life Estate	Remainder
81	0.41967	0.5803
82	0.40295	0.5971
83	0.38642	0.6136
84	0.36998	0.63
85	0.35359	0.6464
86	0.33764	0.6624
87	0.32262	0.6774
88	0.30859	0.6914
89	0.29526	0.7047
90	0.28221	0.7178

Transfer-on-Death Deeds

- aka Ladybird Deeds (some states have both with technical and legal differences, but we will consider them to be the same)
- Enhanced life estate deeds
- Differ from life estate in that transfer of entire property occurs at death, as stated in the deed (for ladybird deeds, the grantor has a power of appointment and if it is not executed, the beneficiary named in the deed gets property)
- Allow grantor to sell or mortgage property without consent of "remaindermen“

Transfer-on-Death Deeds

States allowing them as of 9/2019:

- Alaska
- Arizona
- Arkansas
- California
- Colorado
- Hawaii
- Illinois
- Indiana
- Kansas
- Maine
- Minnesota
- Missouri
- Montana
- Nebraska
- Nevada
- New Mexico
- North Dakota
- Ohio
- Oklahoma
- Oregon
- South Dakota
- Texas
- Utah
- Virginia
- Washington
- West Virginia
- Wisconsin
- Wyoming

Source: The American College of Trust and Estate Counsel
https://www.actec.org/assets/1/6/Transfer_on_Death_Deeds_Survey.pdf

Transfer-on-Death Deeds

- Property in ladybird deed should be countable for Medicaid purposes, or exempt for Medicaid purposes (e.g., if property is exempt homestead), as if deed were never executed
  - See State Medicaid Manual, Publication 45, 3258.9A – where life estate holder has power to sell without consent of remaindermen, full value of asset is countable resource

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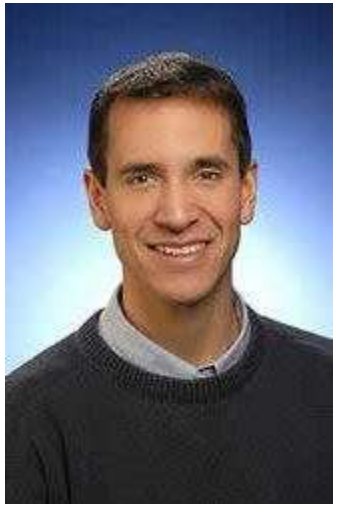
Alternatives to Gifting the House



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June 24, 2020

Long Term Care Insurance

- "Plan A" whenever protecting assets from the nursing home is a major planning objective.
- Comprehensive coverage could eliminate the need to do any gifting.
- "Expensive" is a relative term; premiums are high, but nursing home bills are much higher.
- Take advantage of the "Partnership" program if offered in your state.
- Make sure home care, day care, assisted living facilities and inflation rider is included.

NOT Gifting the House

- Step-up in tax basis when the children inherit the house.
- Clients may sleep better. Eviction, children's creditors and marital issues, 5-year look-back will not be a concern.
- Home's equity can be accessed via reverse mortgage, home equity loan, etc.
- Assess the odds that your client will eventually need permanent nursing home placement.
- Assess the client's "risk tolerance".

Moving / “Down-sizing”

- The home may be too big in light of the clients’ physical/mobility limitations.
- The concept of senior living, assisted living facility, continuing care community, etc. may appeal to the clients.
- Clients get a large capital gains tax exemption for selling the house as their primary residence.
- Day-to-day expenses may be lowered, thereby creating a better financial situation.
- Converting the real estate to cash could facilitate more versatile gifting strategies.

Selling the House to the Children

- Need to assess the children's financial ability to purchase, and how important is it to keep the house in the family.
- Not a Medicaid eligibility problem if clients can verify that it was sold for fair market value.
- Clients get a large capital gains tax exemption for selling the house as their primary residence.
- Children get a relatively high, date-of-purchase tax basis for capital gains tax purposes.
- Clients can continue to live in the house as tenants.