

**Two Topics of Importance: The Massachusetts Estate Tax  
And Sheltering Assets from a Long-Term Nursing Home Stay Under the  
Deficit Reduction Act**

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*I. Nursing Home Issues*

1. Introduction

A nursing homes stay can cost anywhere from \$75,000 to \$90,000 per year. It goes without saying, therefore, that a long-term nursing home stay can easily impoverish all but the wealthiest of families. With proper planning, however, no one has to be wiped out by a nursing home stay. This article will summarize the Medicaid laws, including recent important changes, and will present some powerful ways to shelter assets. Naturally, there is no "one size fits all" solution, and this article is no substitute for a careful analysis of your situation by a competent legal advisor.

2. Medicaid Rules In General

There are different rules for single and married people. A single person in a nursing home has virtually no protection, being required to spend just about all of his assets. In addition to \$2,000 worth of cash assets, a single person may keep a prepaid funeral, personal possessions and jewelry, one automobile, term life insurance and a small whole life insurance policy. In the case of a married couple, the healthy spouse can keep the house, the exempt items just listed and the sum of \$101,640.

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<sup>1</sup> This handout expresses the opinions of the authors, and is designed to present general information regarding the subject matter covered. It is not intended to be used as a substitute for obtaining personal advice of a specific nature from a qualified attorney.

### 3. Changes Made by the Federal Government

With The Deficit Reduction act of 2005 (DRA), Congress made some very harsh changes to the Medicaid eligibility rules. Here is a summary of the law's major provisions:

#### A. Lookback & Disqualification Period

People applying for Medicaid need to disclose transfers of liquid assets or real estate made within a set period of time before the date of application. This period is referred to as the "lookback period." Under the old rules, there was a 60 month lookback period for transfers to irrevocable trusts and a 36 month lookback period for transfers to individuals. Under the DRA, the Medicaid lookback period for *all* asset transfers is now 60 months (five years).

If assets are given away during the lookback period, then Medicaid will assess a penalty: For every \$7,380 given away, there will be a period of Medicaid ineligibility of one month. Under the old law, the Medicaid disqualification period for assets transferred during the lookback period started from the date of transfer. For example, if your mother gives you \$73,800 today, she will be disqualified for Medicaid for the next ten months. As long as the disqualification period is over, then, assuming she otherwise qualified, Medicaid would be approved. The new law changes this rule significantly. Now, the disqualification period runs from the date when the individual enters a nursing home and would otherwise be eligible for Medicaid coverage. In other words, the penalty period does not even begin until the nursing home resident is out of funds and has applied for Medicaid.

Two simple examples will show how these rules work. Let's assume that Uncle Harry gives away \$73,800 on January 1, 2007. Under the old rules, he will be eligible for Medicaid ten months later, or November 1, 2007. The new rules, however, work very differently. Let's say Uncle Harry is perfectly healthy when he makes his \$73,800 gift on January 1, 2007. He suffers a stroke four and one-half years later, and enters the nursing home on June 1, 2011. Let's assume that he has under 2,000 in assets at that time, so he is otherwise eligible for Medicaid. The disqualification as a result of the \$73,800 gift that he made four and one-half years ago *first starts to run* when he applies for Medicaid on June 1, 2011. The disqualification period will run for 10 months from that time, and will end on March 31, 2012. Who will pay for the nursing home during the next ten months? Uncle Harry can't pay, because he is out of money. Unfortunately, no one knows who will pay. Congress did not think that issue through very well.

Under the new rules, people such as Uncle Harry will be penalized for any gifts they have made during the past five years, *regardless of the purpose of the gift*. It does not matter that a

moderate gift was made exclusively for a purpose other than to qualify for Medicaid. Therefore, the new law, for all practical purposes, prohibits any gifting by people who have even a remote chance of needing Medicaid care within the next five years, *i.e.*, all but the wealthiest of Senior Citizens.

#### B. Annuities

The rules concerning annuities have also changed. One way to make someone eligible for Medicaid is to buy an immediate annuity.

Under the new rules, if a Medicaid applicant purchases an annuity, the annuity must name the state as the remainder beneficiary for at least the amount of medical assistance paid. If the applicant is married, then the annuity must name the state as the remainder beneficiary in the second position after the community spouse or minor or disabled child.

In the proper case, an annuity can still be used to make someone eligible for Medicaid; it's just that the state is the beneficiary if that person dies within the term of the annuity. If the person outlives the annuity, then the state will not receive anything from the annuity proceeds. Therefore, there is nothing to lose in doing the annuity. That is, if the annuity is not purchased, then all of the countable assets are subject to being spent down. With the annuity, the person can immediately qualify for Medicaid, and there is a chance that some assets will be protected. It is important to note that the subject of annuities is enormously complicated, and this article only provides a very brief introduction to the subject.

#### C. Home Equity

The new law contains an absolute bar on Medicaid eligibility for any unmarried person who has over \$500,000 worth of equity in his or her home. (Each state has the right to raise this figure to \$750,000, and Massachusetts has done so.) Even if this person has no other assets at all, but has a house with over \$750,000 in equity, he or she cannot obtain Medicaid, regardless of whether the house is on the market or not.

### 4. The Solutions

Although the federal government has made Medicaid planning more difficult, it is still possible to shelter assets from the nursing home. Here are a sampling of the techniques that are still available.

#### A. The Medicaid Trust

An irrevocable trust known as a "Medicaid Trust" is a powerful and proven technique of protecting assets. Whatever assets you wish to shelter are placed into the trust. You are entitled to receive all income or dividends generated by those assets. You cannot directly receive principal, however, because, if you could, it would be subject to the nursing home.

Some people use the irrevocable trust to shelter their real estate only, while others use it to shelter their real estate and some, or all, of their investments. As explained above, there is a five-year lookback period on all irrevocable trusts. Therefore, people who are relatively healthy, and who are not expected to go into a nursing home within five years, would do well to consider such a trust in their estate planning portfolio.

#### B. Deed with Special Power of Appointment

As an alternative to the Medicaid Trust, the deed with Special Power of Appointment is a method of sheltering your real estate. A deed of the property is made to your children. In the deed, you retain a Special Power of Appointment, which, in effect, allows you to transfer ownership, even *after* the deed has been recorded, from your children to other persons.

The Deed with Special Power of Appointment has several advantages. First, the property is out of your name, and, after the lookback period is safe from the nursing home. Second, the special power of appointment allows you to control your children: if they do not do what you want them to do, you can take the house away from them after the fact. Third, the special power of appointment preserves the "stepped-up basis," which is an important tax benefit that your children receive at your death.

#### C. The Pourover Trust

The Pourover Trust is revolutionary in that it allows a married couple to shelter assets from the nursing home using a trust that is completely revocable, that can be amended at any time, that allows unfettered access to the money, and that does not have a lookback period. The pourover trust makes clever use of what is known as a "testamentary trust" coupled with a will and revocable trust. Federal law states that if a testamentary trust is written in the correct way, the assets therein will not be available to the nursing home; *i.e.*, it will be sheltered.

In the case of a married couple, in all but the most unusual case, one spouse will die before the other. Since we do not know who will be the first to die, we create a joint husband and wife revocable trust. The assets to be protected from the nursing home are placed into that trust. While both spouses are alive, they can use the trust assets as they wish, without any restrictions or involvement of the children. The trust states that on the first

death, some or all of the assets are to "pour over" to the estate of the spouse who has died. At this point, the will of that spouse takes over. The will creates a testamentary trust for the benefit of the surviving spouse. That testamentary trust says that the funds are to be used for the care, comfort and maintenance of the surviving spouse, to maintain the spouse in his or her accustomed standard of living. Usually, one or more of the children act as trustees. Since testamentary trusts are exempt from the nursing home, the assets in the trust are protected! The nursing home does not have access to those assets.

The beauty of the Pourover Trust lies in the fact that during the lifetime of both spouses, the trust is revocable, and the spouses are free to do whatever they want with the assets, without the children being involved at all. Additionally, the Pourover Trust, being revocable, has no lookback period and is effective immediately. The trust can also be tailored to fit the needs of the client. That is, there is no requirement that all of the assets be placed into the trust. Whatever the couple wants to protect from the nursing home is put in the Pourover Trust, and the rest of the assets can be left out.

#### D. Planning for Those Already in a Nursing Home

While the government has cut back on the ability to shelter assets for people already in a nursing home, it is still usually possible to do so. One technique, concerning annuities, has already been mentioned. An annuity is a financial device that converts assets into income. In the case of a married couple, the income can be directed to the healthy spouse, and can thus be protected from being spent down. In the case of a single person, the annuity can get the person eligible for Medicaid right away, and can stretch out how long the person's money lasts. The law surrounding annuities is enormously complex, and is far too intricate to summarize here. Anyone with a loved one in a nursing home who is interested in sheltering assets owes it to themselves to get more information on annuities.

A second technique is known as the "Reverse Half a Loaf." The Reverse Half a Loaf is a technique of extraordinary complexity and sophistication by which it is possible to shelter about half of the assets of a nursing home resident. The law surrounding the Reverse Half a Loaf is even more complex than the law surrounding annuities, and is also too complex to summarize here. In the right case, however, it can be used to protect a good deal of the assets for someone who is already in the nursing home.

#### 5. Conclusion

The new laws have put Seniors who are uninformed at greater risk than ever of losing their nest egg. Fortunately, the door has not closed on many Medicaid Planning techniques such as the

irrevocable Medicaid Trust. Therefore, in this sense, seniors that are well-informed can still protect themselves and their families, which is why the importance of asset protection is more crucial now than ever.

## *II. The Massachusetts Estate Tax*

When someone dies, his or her estate may be subject to a tax known as the estate tax. Generally, all of the assets that someone owned in at the time of death are subject to estate taxes, as are gifts over a certain amount made during life. If the total of the assets and gifts are above a certain threshold, then the estate tax is imposed, and if the assets are below that threshold, there is no tax.

If a tax is due, it must be paid within nine months from the date of death. The federal estate tax threshold will be \$2 million for the years 2006 through 2008 and \$2.5 million in 2009. In 2010 there will be no federal estate tax at all, but then in 2011 it will come back at \$1 million. In addition to the federal estate tax, Massachusetts now has its own estate tax, with a filing threshold is \$1 million. Due to the rapid escalation of real estate values in recent years, many people who do not think of themselves as wealthy will nevertheless be subject to the Massachusetts estate tax.

Before the Massachusetts tax went into effect, a typical "dual revocable trust" estate plan would include an individual trust for each spouse, each trust being funded with approximately half of the total estate. After the death of the first spouse, his or her trust assets are allocated into two separate sub-trusts, the so-called "A-B Trust." The first sub-trust, funded with the amount exempt under federal law, is known as the Family Trust. Under the Family Trust, assets are available to the surviving spouse and children (but principally the surviving spouse) for health, maintenance, education and support. In this way, the trust assets can be used for the support of the surviving spouse, but are held in a way that those assets are not part of his or her taxable estate. The rest of the assets belonging to the trust of the first spouse to die pass into another sub-trust called the "Marital Trust." The Marital Trust provides the surviving spouse with all of the income, and also often gives the trustee discretion to distribute principal as necessary for the surviving spouse's maintenance and health. The Marital Trust is not taxed at the death of the first. Upon the surviving spouse's death, the assets left in the Family Trust and Marital Trust pass to the heirs.

Under the A-B type of estate plan, there are no estate taxes at the first death, and, at the second death, estate taxes are either eliminated or minimized. Before Massachusetts enacted its estate tax, estate planning for a married couple with a taxable estate was handled as described above. Now, however, the landscape has completely changed. If the Family Trust is funded with an amount of money that is less than the Federal exemption (\$2 million) but more than the state exemption (\$1 million) an estate tax will be due at the first death. To eliminate this problem, the Massachusetts Department of Revenue has ruled that the Marital Trust for Massachusetts tax purposes (remember, the

Marital Trust is not taxed at the first death) can be different for the Marital Trust for federal estate tax purposes. Therefore, the amount going into the Family Trust and Marital Trusts can be different for purposes of the federal and Massachusetts tax purposes, and taxes to both the IRS and the state are eliminated or minimized.

As a result of these tax law, many Massachusetts estate plans *need to be re-written, and all should be re-evaluated.* Any married couple with an estate over \$1 million (or approaching \$1 million) should be concerned about these tax issues, and virtually all clients should be concerned about nursing home protection.