# ESTATE PLANNING

*Ideas to Help You Plan for Your Future*

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## 18 YEARS OLD? HEALTHY? GET YOUR NURSING HOME INSURANCE NOW!

In late December, 2005, Vice President Cheney cast the tie-breaking vote in the Senate to pass the Deficit Reduction Act (DRA) of 2005. The DRA has drastically changed the Medicaid rules, and will force many families to spend their life savings on nursing homes.

When an individual enters a nursing home, he has to pay for his care until virtually all of his assets are consumed. At that point he qualifies for Medicaid, which is a state and federally funded program for medical care for the poor. As you may recall, Medicaid pays for nursing home care. Medicare, the government-sponsored health insurance for the elderly, does not pay for long-term nursing home care.

> *"When an individual enters a nursing home, he has to pay for his care until virtually all of his assets are consumed."*

If the nursing home patient is married and his spouse still lives in the community, she may retain a house, a car and about $90,000 in other assets. She may also receive about $2,400 per month in income from their joint income. Everything else – excess assets and excess income – must be spent on the nursing home. Once the excess assets are gone the couple may qualify for Medicaid.

Prior to the enactment of the DRA, one of the ways of preserving some assets for the family was to make gifts. If gifts were made more than three years prior to applying for Medicaid, those gifts would not be considered in the Medicaid application. This was referred to as the three-year lookback.

If gifts had been made during the three years preceding the Medicaid application, a penalty period would be calculated by dividing the amount of the gifts by the amount of the state-determined average cost of a nursing home. The result of that calculation would be the "penalty period" - that is, the period measured from the date of the gift, during which the individual would be ineligible for Medicaid.

For instance, if a gift of say $58,000 was made one year prior to applying for Medicaid, and if the state-determined average cost of a nursing home was $5,800, per month, then the gift of $58,000 would be divided by $5,800 to arrive at a penalty period of 10 months. That period of ineligibility would commence to run from the date of the gift.

In our example, since the applicant sought Medicaid one year after the gift, the penalty period would have expired and the applicant would qualify for Medicaid.

Thus, if someone had not planned, and was suddenly about to be thrust into a nursing home, we would sometimes have him make gifts of roughly half of his property. He would retain enough to pay for the nursing home while the penalty period ran, so that when the penalty period ended his assets would about run out and he would go on Medicaid.

Under the revised rules of the DRA all that has changed.

Now, the "lookback" period is five years rather than three years. That means that if you run out of money and apply for Medicaid to pay for your nursing home, the Department of Social Services will go back five years to see if you have made any gifts.

If gifts are found to have been made during that five-year period, the penalty period will be calculated in the same way – amount of gift divided by the average cost of a nursing home in your area.

However, the penalty period will not begin to run until you would otherwise be eligible for Medicaid. That is, the penalty period will not start to run until you have exhausted your assets, and are indigent.

So, what happens then? Since you are out of money, who will pay for your nursing home care?

Well, because Medicaid won't pay for your nursing

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# FLORIDA: THE TAX HAVEN STATE

For many years Florida has been known as the haven for those of us who don't like to pay taxes. They have no income tax, and they have no estate tax.

However, they did have an Intangibles Tax on things like stocks and bonds. It was not a huge tax, and for many people it was merely an annoyance. However, for folks with substantial investments, the tax could become significant.

The tax was imposed on all investments held as of the first of the year. Because the date of taxation is January 1, someone came up with the novel idea of creating an irrevocable trust with an out-of-state trustee, and transferring assets to that trust so that on January 1 title to the stock was not in the name of the Florida resident. The trustee would have the discretion under the terms of the trust agreement to transfer the stock back to the Florida resident at any time.

So, the Florida resident would direct his broker to transfer the stock to brokerage account of the trustee on December 15. On February 1 the trustee would direct the broker to transfer the stock back to the Florida resident.

The Florida resident would not report any stocks as being owned on January 1, and if the Florida Department of Revenue asked, the Florida resident could give the Department a copy of his brokerage statement showing that he did not hold any stock on January 1. Therefore, he owed no tax.

*"The Florida Legislature has passed repeal of the Intangibles Tax, and Governor Jeb Bush has signed that into law."*

This practice became so common that the Florida Department of Revenue even adopted rulings as to what trusts they would permit to play this game.

Well, that game is no longer required. The Florida Legislature has passed repeal of the Intangibles Tax, and Governor Jeb Bush has signed that into law.

So now Florida no longer has an Intangibles Tax – another reason to move to the Sunshine State!

# FEDERAL ESTATE TAX LAWS KEEP ON CHANGING. SO, WHAT ELSE IS NEW?

There have been a number of significant changes in the federal estate tax in the past two years. Wills and trusts drawn only a few years ago may need revision. Now would be a good time to review your Will to see if it needs to be changed.

Most notably, the amount which is currently exempt from federal estate tax has increased to $2 million. That exemption is supposed to increase to $3.5 million in 2009. Further the estate tax is supposed to be repealed for one year in 2010, and then come back with only a $1 million exemption in 2011.

In the past session of Congress, a bill to permanently repeal the federal estate tax after 2010 passed the House of Representatives, but failed to pass the Senate. Various compromises were discussed in the Senate, including a $5 million exemption, but none of them could get any traction.

If I have to guess, I would guess that the exemption won't drop below $2 million, even in 2011. Most observers don't believe that the estate tax will be entirely repealed. So, I am suggesting that clients plan based upon a $2 million estate tax exemption, but with some flexibility in case the exemption increases.

For married couples who properly plan, the $2 million exemption means that a total of $4 million can be passed to the next generation without any federal estate tax – $2 million per spouse. Since the combined state and federal estate tax brackets on amounts in excess of $2 million can approach 51% or more, planning in order to maximize the use of the $2 million exemption in both estates of a husband and wife is imperative.

For individuals with $2 million, or less, the higher exemption is an opportunity to simplify estate plans. Only a few years ago when the estate tax exemption was $600,000, many Wills had provisions which contained

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so-called "by-pass" trusts. The trust would hold the amount of the exemption so that it would not be subject to estate tax in the estate of the surviving spouse.

Now, if the combined estate of husband and wife is less than $2 million, such a trust is not necessary, and you can simply leave your entire estate to your spouse.

For married couples whose estates are about $2 million, I am suggesting that they have Wills which contain a "disclaimer trust". This Will leaves everything to the spouse, but provides that if the spouse disclaims any portion of her bequest, the disclaimed portion will go into a trust for the benefit of the spouse. The spouse will get the income from the trust, the principal will be available if she needs it, but the trust will not be taxed in her estate.

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For instance, if the first spouse died and the total estate was $2,150,000, the surviving spouse may disclaim a portion of her bequest so that this portion would fall into the disclaimer trust, because if she died with an estate of $2,150,000 the federal taxes would be $69,000. If the spouse were to disclaim $150,00 and allowed the money to go into trust, the potential Federal estate taxes would be avoided and the family would save $69,000.

Or, the spouse might choose to avoid the trust, and merely make annual $12,000 gifts to children and grandchildren to reduce her estate.

The disclaimer trust at least gives the spouse the flexibility of having a trust to save estate taxes, or avoiding the complications of a trust and choosing other means to avoid potential estate taxes.

In addition to the increase in the federal estate tax exemption, the annual exclusion for gift tax purposes has increased to $12,000 per person. That means that you can make gifts of $12,000 per person without filing any gift tax. If you are married, your spouse may consent to having half of your gifts treated as hers, and the annual gifts may be increased to $24,000 per person.

The federal gift tax exemption, which is in addition to the annual $12,000 gift tax exclusion just discussed, is still only $1 million. That is, in addition to being able to give away $12,000 per year per person, without paying federal gift tax, you may also give over your lifetime an additional $1 million and not pay federal gift tax.

The gift tax exemption of $1 million did not go up when the estate tax exemption was increased to $2 million. The reason for this is that Congress was afraid that if the gift tax exemption was higher, wealthy people would make gifts to their children who are in lower income tax brackets, so that the income earned on the gifted assets would pay less income tax.

For people of very significant wealth there was formerly some benefit in making taxable gifts and paying the gift tax. The future appreciation and future income on the gifted property would be out of the estate, as would the gift tax money, so those monies would not be subject to eventual estate tax. Further, the gift tax paid would be a credit against the eventual estate tax.

However, with the possibility, albeit small, that the estate tax may be repealed, paying gift tax is a strategy I am not anxious to recommend to clients.

While U.S. citizens may give any amount they like to their spouses without gift tax, that is not true of resident aliens. Resident aliens are limited in the amount they may give to their spouses without paying a gift tax. However, that amount which an alien residing in the U.S. may give to his or her spouse has increased this year to $120,000 per year. This is helpful to aliens who plan to stay in the U.S. and who, as a result, will eventually be subject to U.S. estate tax.

In addition to the changes in the amounts which are exempt from gift and estate tax, in recent years the alternatives which are available for designating beneficiaries of IRAs and other retirement vehicles have increased. These changes simplify IRA beneficiary designations and may allow more money to stay in the IRA longer.

Further, the rule changes liberalize the use of trusts as beneficiaries of IRAs. So, if you were concerned about naming a child or grandchild as the beneficiary of an IRA because he or she might squander the money, you can now more easily designate a trust for that child or grandchild as beneficiary.

Beginning in 2007, beneficiaries of 401(k) plans will be able to roll over those benefits into an IRA and withdraw the funds over their life expectancies. Formerly, that rollover to an IRA was only available to surviving spouses.

This could be quite useful if the 401(k) plan requires that the beneficiary withdraw his funds and does not permit a deferral of withdrawal.

The recent tax law changes, if taken advantage of, could make things quite a bit easier for many families. This would be a good time to review your estate planning, and while you are at it, make sure that your Power of Attorney and your medical advance directive – Health Care Proxy, or Health Care Power of Attorney – are current.

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home care, it will be necessary for you to attempt to get back the money you gave away. The nursing home cannot put you out on the street if you need care. If you can't get the money back from the recipients of the gifts, the nursing home might sue the recipients, claiming that the gifts were transfers made by you with the intent to defraud a future creditor – the nursing home. Whether the nursing home would be successful is questionable, but your family might be inclined to simply give the money back, rather than spend funds on litigation defending the gifts.

Any way you look at it, the picture is not pretty. What should someone do to plan so that at least something could be left for family members?

One possibility would be to purchase long-term care insurance. That will pay some or all of your nursing home expense. If you make gifts within the five-year lookback period, having insurance which will pay for the nursing home may help you get past the five-year anniversary of the gifts.

For instance, I might have a nursing home policy which will pay for three years of nursing home expense. I could make gifts, retaining sufficient assets to pay for two years of nursing home expense. The retained assets, plus the nursing home insurance, would get me past the five-year lookback.

Further, the unfortunate fact is that most folks don't live more than three years in a nursing home. Therefore, having coverage for three years may completely take care of the problem.

Indeed, in some states such as New York, insurance companies are allowed to sell so-called "partnership" long-term care policies. Those policies provide nursing home coverage for three years, and after that you can qualify for Medicaid, even if you have excess assets. Your income must still be applied to your nursing home care before Medicaid will pay, but your assets are not touched and can be left to your family.

This type of coverage is not cheap, premiums can run into the range of $5,000 per year or more. However, when compared with nursing home costs of $5,000 to $10,000 per month, the annual cost of the insurance is often less than the cost of one month in the nursing home.

Also, some policies now have riders you can purchase which will refund all of your nursing home insurance premiums to your estate if you never use the coverage.

Long-term care insurance premiums are based upon the applicant's age and health. So, many older folks who are in poor health do not qualify for long-term care insurance.

Another alternative strategy to protect assets for your family would be to make gifts, and then trust the recipients to spend the money on your nursing home care if that becomes necessary.

For instance, I might give substantial assets to my children, with the informal understanding that if I go into a nursing home within five years of the gift, my children will spend some or all of the money they got from me to pay for my nursing home until the five years have expired, at which time I will apply for Medicaid.

One potential problem with that is my child could die, and the money could wind up in her estate or passing to her spouse. This could be addressed by having all of the children use the money I gave them to set up a trust, under which the trustees would have discretion to use the funds to pay for my nursing home expenses. After I die, the money remaining in the trust could be returned to my schildren.

Or, my children could change their Wills to direct that if they died a trust would be created for me with the money I gave them. If properly drawn such a trust would not be considered an available asset which would disqualify me from Medicaid coverage.

Another potential problem with making gifts to my children and depending upon them to pay for my nursing home, is that a child could get into creditor problems, and her creditors might attach the money I gave her. That might not be solved by the child creating a trust under which she will get the money back when I die, since creditors can often reach so-called self-settled trusts.

Irrevocable annuities also were formerly used to attempt to preserve assets for the family. Just before applying for Medicaid an individual would put money into an annuity of which he was the life annuitant, and his family members were the beneficiaries. If the annuity payments to the individual would exhaust the annuity if he lived to his full life expectancy, the purchase of the annuity would be disregarded in determining his Medicaid application. While he was alive the annuity payments would have to be spent on the nursing home.

If an individual did not live out his life expectancy, what was left in the annuity at his death would pass to his beneficiaries.

Under the new Medicaid rules, setting up such an annuity will be considered a transfer which will create a penalty period, unless the remainder beneficiary of the annuity is the State. Thus, there is little reason to set up such an annuity, since the annual payments would have to be used to pay for the nursing home, and what is left in the annuity at death would go to the State.

The new Medicaid rules are going to force a great many more of us to use up our entire life savings on nursing home expenses, and it appears that the only way to avoid that will either be very early planning, or taking out long term care insurance, or a combination of both.