



## **WHAT IS A MEDICAID ASSET PROTECTION TRUST**

by

**John F. Robbert, Attorney at Law**

*Admitted in Delaware, Maryland, and Louisiana*

A trust, in general terms, is nothing but a set of instructions that a Trustmaker gives to a Trustee who agrees to carry out those instructions. A trust may be revocable or irrevocable. A Medicaid Asset Protection Trust is irrevocable but irrevocability does not mean inflexible. After you create the trust you transfer your assets to the trust; such transfers are considered a “gift” for Medicaid purposes but are not considered as “completed gifts” for purposes of the estate and gift tax.

By signing the trust instrument (that is, the Trust Agreement), you create a new legal entity, or legal being. This is the Trust itself. Within it, you establish a number of rights and responsibilities for persons named in the Trust. These persons serve four roles.

The first is the role of “Trustmaker.” The Trustmaker of a trust is the creator of the trust. When married, husband and wife are the creators of the Trust, and therefore the Trustmakers of the Trust, and they will transfer their assets into it.

The second is the role of “Trustee.” The Trustee of a trust manages the trust, makes decisions regarding the use of trust assets, and makes distributions pursuant to the terms of the trust. Typically one or more of your children are appointed as Initial Trustees of your Trust. You may also appoint a Successor Trustee in the event that the Initial Trustees are unable or unwilling to serve.

The third is the role of “beneficiary.” A trust exists for the benefit of the beneficiaries. A trust has two types of beneficiaries: the income beneficiaries, who are the recipients of distributions of trust income, and the principal beneficiaries, who are the recipients of distributions of trust principal. While you are alive, both the income and principal beneficiaries of your Trust are usually your descendants, who may receive distributions at the Trustee’s discretion.

After both of you have died, the income and principal beneficiaries of your Trust are, in most cases, your descendants, *per stirpes*, who will receive their shares in trust as specified in your Trust. (Trusts for each child can be individually structured to meet the needs of each child. *Per stirpes* means one share for each child who survives you and one share for a deceased child who leaves children.)

The fourth is the role of “Trust Protector.” A Trust Protector is responsible for protecting the purpose and intent of the trust. In your Trust, the Trust Protector will have the limited ability to make certain amendments to the Trust, and fill Trustee vacancies. The Trust Protector cannot, however, change the beneficiaries of the Trust.

Your Trust is a “Medicaid Asset Protection Trust,” meaning the assets transferred to it are protected from counting as resources for Medicaid qualification purposes. Your Trust is “irrevocable,” meaning that you, as Trustmakers, have given up the power to revoke the Trust and cannot thereby end its existence.

**No Amendment of Trust Permitted:** You **do not** have the power to amend your Trust. This means that you cannot change any of its terms. You do, however, have a “limited power of appointment” to change the remainder beneficiaries of the Trust estate through your Wills, living trusts, or other written instrument. The power of appointment is “limited” in that you can only appoint the assets to your descendants, and not to yourselves, your estates, your creditors, or the creditors of your estates. Further, this power is a “testamentary” power, meaning that the instructions you leave will be effective upon your death.

Although the provisions of the trust cannot be changed, your Trustee has the power to change investments, buy and sell assets, and, generally, manage your assets as you would have done.

**Tax Issues:** Your Trust is a “grantor trust” for income tax purposes. As such, trust income may be reported under either the social security number of the husband or wife, but it is a good idea to be consistent. Because income is reported on your social security number, no separate income tax return needs to be filed for the trust.

Because the Trust is a “grantor trust” under the Internal Revenue Code, any income generated by Trust assets will need to be reported on your tax return, regardless of whether you, as Trustmakers choose to receive such income or if such income is being accumulated in the Trust and not paid out to either of you. You will file your

return just as you have always done; the Trust does not file a separate return.

One of the advantages of a grantor trust is that you still have the benefit of Section 121 of the IRS Code which eliminates any capital gain tax on the first \$500,000 (\$250,000 for a single person) of gain upon the sale of your residence. At the time of death, the cost basis of the assets in the Trust are also adjusted to reflect the value as of the date of death.

### **Other Features of the Trust:**

#### **1. Special Power of Appointment**

In creating this Trust, you have reserved a Special Power of Appointment. This means that an incomplete gift has been made for tax purposes and any appreciated assets placed into the Trust will receive a step-up in basis upon the second death. It also means that the value of these assets will be brought back into your estate for estate tax purposes. This should not present a problem as long as you do not have a taxable estate; therefore, no estate tax will be due, notwithstanding the inclusion of these assets in your estate.

#### **2. Distributions to Lifetime Beneficiary/Trustee**

When a lifetime beneficiary of the Trust is also a Trustee, distributions to the Beneficiary/Trustee must be limited to an “ascertainable standard” for tax purposes. This means that distributions can only be made to them for their health, education, maintenance, and support. This language prevents what is known as a general power of appointment, which would otherwise cause the Trust assets to be includable in their estate in the event that the beneficiary predeceases you.

While either of you are alive, distributions do not need to be made equally to the beneficiaries Income Tax Returns. Please be advised that this Trust is a “grantor trust” under the Internal Revenue Code. Please note that any income generated by Trust assets will need to be reported on your tax return, regardless of whether you, as Trustmakers chose to receive such income or if such income is being accumulated in the Trust and not paid out to either of you. You will file your return with the same information as before.

### **3. Distributions of Income and Principal to You**

You are not beneficiaries of Trust principal. Although income may be distributed to you, I do not recommend it and most clients elect not to receive income from the Trust. This means that if either of you later qualifies for Medicaid, Trust income will not be budgeted by Medicaid as available income for Medicaid eligibility purposes. Under no circumstances may principal of the Trust be paid to or for the benefit of either of you.

### **FUNDING YOUR TRUST**

Your assets must be transferred into the Trust if it is to achieve its objectives. This is commonly known as “funding your Trust.”

The Trustee only has control of the property if it is in the Trust. You have no control of your assets once they have been transferred into the Trust. The major reason for establishing the Trust (that is, removal of assets from your ownership) will only be achieved if the assets are transferred into the Trust.

**To the extent that you, as Trustmakers, do not transfer assets into your Trust, such assets will not be protected for Medicaid eligibility purposes.**

**How Much Should Go Into the Trust:** You should transfer as much of your assets at one time that you wish to protect from being considered an available resource for Medicaid purposes to an account (or various accounts) opened in the name of your Trust. Furthermore, the transfers made into the Trust are subject to a 60-month lookback period for Medicaid eligibility purposes. Therefore, depending upon the amount of assets used to fund your Irrevocable Trust and other factors relating to Medicaid eligibility as required by the Deficit Reduction Act of 2005, either of you might not qualify for Medicaid benefits for a full 60 months after the month in which your Irrevocable Trust is funded.

**In What “Name” Will Your Trustee Hold These Assets?** We recommend that the title to Trust assets be held by the Trustees in substantially the following format:

Sonny Sample, Trustee of the Sample Irrevocable Trust dated January 20, 2014

Sometimes, banks or other financial institutions prefer a slightly different format for the titling of Trust assets. This is not a problem. The important thing is to be sure that your Trust is not confused with any other trust and that the assets are clearly held in the name of your Trustees.

**Placing Specific Assets Into Your Trust:** Each and every one of your assets is reviewed as part of the counseling process during the creation and implementation of your trust. Once you have decided which ones are to go into your trust, we work with you to make that happen.

**a) Real Property**

Real property may generally be transferred into an Irrevocable Trust.

Some Clerk of Court's offices will scrutinize transfers of real property into Trusts. If you have advised us that you wish to fund your Trust with your residence, then we have included language in the Trust that clearly preserves your right to any and all continued property exemptions (such as homestead exemption). However, we cannot control the actions of the Clerk of Court's offices. Please carefully review your next tax bill and any documentation regarding exemptions you receive to ensure that any previously granted exemptions are stated thereon.

If your property is encumbered by a mortgage, we strongly recommend that you obtain the existing lender's approval of the proposed transfer before the transfer is made.

If any rental property is conveyed to your Trust, all future rental payments should be made to the Trustee of the Trust. You will need to notify your existing tenants of the change. Moreover, your lease should be reviewed to make sure that an assignment of the lease to your Trust is not prohibited.

**b) Savings Accounts and Certificates of Deposit**

Banks and similar institutions commonly see Trusts and are used to helping their depositors with necessary changes. A copy of the Trust Agreement is usually required. If a particular savings account cannot be transferred before a set date without losing interest, you may decide to wait, although this could

extend the Medicaid penalty period.

Please note that some banks view the retitling of a Certificate of Deposit (CD) as a change in ownership, requiring a new CD to be issued. This could result in the forfeiture of some of the interest that the CD would have earned. The amount of forfeiture will depend on the financial institution, but a forfeiture of 3 months of interest, or more, is not unheard of. As noted above, it is imperative that we transfer all CDs into your Trust immediately, even if some interest is forfeited as a result.

**c) Checking Accounts**

While such accounts can, and in some cases should, be put into the name of your Trust, you may want to leave one account in your individual names, especially if income is deposited directly into the checking account. Bank records must indicate which checking accounts are held in the name of the Trust and which accounts are held in your individual names.

**d) Life Insurance Policies**

In most cases, the owner and the beneficiary should be your Trust. You may have personal reasons for naming a particular individual as beneficiary, in which case upon your death the proceeds of the policy will neither go into your Trust nor be distributed under its terms, but will pass according to your beneficiary designation by operation of law.

**e) Stock/Securities**

The transfer of stock to the Trust must be accomplished by changing title on the stock certificates themselves. In some cases, your broker can help you make this change without charge. In other cases, a small charge per certificate may be required. If, however, you hold shares through a brokerage account, you only need to change the title on the brokerage account, rather than on each share certificate.

**f) Individual Retirement Accounts (IRAs)**

Individual Retirement Accounts (IRAs) must be held in the name of the

individual who created the accounts. Thus, IRAs cannot be transferred into your Trust. In most states, the entire IRA does not need to be spent down to qualify for Medicaid, but the distributions from the IRA to you (what is commonly known as the “required minimum distribution”) will be considered as an income resource to you for Medicaid purposes.

**g) Automobiles**

At this time, we do not recommend that you transfer your automobile to the Trust, as there is an exception under current Medicaid law for ownership of one automobile.

If, however, you have a number of automobiles, or automobiles of particularly high value, these probably should be transferred to the Trust.

**h) Other Personal Property**

Airplanes, yachts, horses, art work, copyrights, patents, royalty contracts, a family business, stock options, mobile homes, or partnership interests may all go into the trust.

Personal property items (jewelry, furs, furniture, and art objects, etc.) that are very valuable such that they may be considered “resources” for Medicaid purposes, should be transferred by a general assignment with particular descriptions of valued items and a provision to cover after-acquired items.

**DISPOSITION UPON YOUR DEATH**

When the first of you passes away, the trust is not changed and the administration of it continues as it did before that first death. Upon the second death, in the typical trust the assets are distributed to your heirs but kept in trust in order to protect your beneficiary’s assets from ex-spouses and other creditors and predators. Your beneficiary may serve as a trustee of his or her own trust.

Presumably, all or most of your assets will be owned by your Irrevocable Trust and will not be subject to disposition by your Last Will and Testament. Your Last Will and Testament will provide for the disposition of any assets that, either by design or

inadvertence, have not been registered in the name of your Irrevocable Trust; such assets will “pour over” to the trust. If all of your assets are effectively owned by your Irrevocable Trust, probate administration of your Will should not be required. Any property held in joint tenancy with right of survivorship will not be considered an asset of your Irrevocable Trust, but will pass by operation of law to the joint tenant, again eliminating the need for probate.

As with any legal matter, do not rely on this explanation. It is meant to give a very general description of the Medicaid Asset Protection Trust and without any regard to your unique extenuating circumstances.

rev: August 18, 2023