10 THINGS YOU MUST KNOW TO HELP YOUR ELDER LAW CLIENTS

(A PRIMER ON BASIC ELDER LAW
ISSUES WITH DISCUSSION
OF VARIOUS STRATEGIES)

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INTRODUCTION

Elder law has grown in to a major aspect of estate planning. Your clients are thinking about it, and asking about it. Every practitioner needs to know certain aspects of this area of practice, so that issues can be spotted, and problems avoided.

In my practice, in my estate questionnaire that clients fill out before seeing me, I ask clients whether they are interested in "protecting assets from possible long term care costs." Consistently clients rank this answer as being what is most important to them. I have heard the definition of estate planning, as being: getting what you want, to whom you want, when you want, while avoiding probate, reducing taxes, and keeping control. I would suggest that protecting assets from long term care costs might be added to this definition.

Does this mean that all clients need to engage me in elder law planning? No, but for that client who is concerned about it, I will educate them on what will happen if they end up going to a nursing home.

Some clients will say, "I am never going into a nursing home." This simple feint should not derail the issue. Nobody, with rare exceptions, ever *wants* to go to the nursing home. But nursing homes are filled with people. A study by the New England Journal of Medicine cited the percentage of people who may need nursing home care:

- For those dying between 65-74, 17% would need nursing home care.
- For those dying between 75-84, 36% would need nursing home care.
- For those dying between 85-94, 60% would need nursing home care.

Statistically, I have heard the average stay inside a nursing home is two years. If we assume Medicare (with a Medicare supplement policy) might pay for up to 100 days, we have (on average) about $210,000 of exposure. ((24 months less 3 months) x $10,000)

The usual entrance to a nursing home is from a hospital. The client is weak, in pain, and disengaged. Often the thought of returning home when health is so compromised is out of the question. In fact, I have seen many clients actually embrace the structured, safe, environment provided by nursing homes.

Planning for these events may provide huge benefits to our clients. Educating them on ways to stay in the community for as long as possible, while retaining their dignity, independence, and financial security, is too important to be overlooked.

So, how do we help our clients do this? The field of "elder law" is broad. To some extent the field of elder law is an amalgam of several areas of law. Many elder law attorneys began as social workers, teachers or worked within Legal Services for the indigent. These lawyers are often well connected in the community, and can help elders locate and obtain much needed home-based services. Some elder law attorneys were and remain litigators, and protect and advocate for our elder population in the areas of discrimination and nursing home mistreatment. Other elder lawyers, like myself, are tax and estate planning lawyers who have added this area of practice as another "arrow in our quiver."

It is this intersection of estate planning and elder law planning where I spend most of my time. Too often, clients will come in and say "I was told I cannot do elder law planning" or "If I do elder law planning, then I lose control over all my assets" or "I do not have 5 years to do elder law planning."

I have found that elder law is not black and white, but operates in many shades of gray. What a client can do is not always what a client should do.

This area of law requires:

- educating the client on what might really happen in their situation (often it is not as dire as they believed),
- the planning options they may have now (and in times of crisis) and
- repercussions their actions will have (how much control will they lose, if any, and will they be financially disadvantaged in the future).

Clients will come into your office in one of two modes. The "planning" mode client represents a client in relatively good health, who is not too old, and who wants to discuss how to protect assets from nursing home costs. The "crisis" mode client represents a client who comes in on the "eve" of a nursing home stay. This client has not done planning yet, and wants to know what can still be done to protect assets.

The purpose of this lecture is to share with you issues I have encountered, so that issues can be spotted, and to offer some solutions and or planning ideas that I have used in the past to help out clients. I will refer to these differing modes in the outline.

#1 KNOW WHERE YOU STAND

A client will come into your office and say: "I want to protect my assets from nursing home costs. I do not want the state to take everything." This client needs to be educated on (1) what the client's exposure really is, (2) what assets the state will require to be spent down, (3) what the state might take upon death, and (4) the detriment to the client from engaging in this type of planning.

I strongly believe that before advice can be given about what action to take, the client's situation needs to be evaluated in the light of "what happens if he does nothing?"

<u>What is the Client's Exposure?</u> The risks to the client are really based on age and health. A younger client will probably not need nursing home care soon, whereas an elder client might. Certain illnesses cause concern. A client who has the beginning stages of dementia, or has a degenerative illness such as Parkinson's Disease or Multiple Sclerosis might need more aggressive planning.

Statistics might be shared with the client. It has been said that the average nursing home stay is 2 years. (Although I have found most of my client's stay to be shorter; around 6 months.)

In my practice clients will usually takes steps to protect assets starting at age 65 and up. There are some clients who insist upon doing it earlier. For younger clients interested in this type of planning, I encourage the use of long-term care insurance.

What Will the State "Take"? This is a misconception. Clients have images of the state swooping in and taking their assets while they are living. This is not true. In reality, what occurs is that the state will *not* pay for care if the applicant *"owns too much"* or *"if there has been a gift within 5 years of application."* If the applicant owns too much, then upon application, the application will be denied for being "over assets", and the applicant will be directed to return when his assets have reached the requisite levels. If the applicant has made a gift within 5 years of application, a penalty will apply which will preclude benefits for a period of time.

Upon Death, What Does the State Take? Upon death, the state attempts to collect the amount that it has paid for the applicant's care. The state files a probate lien, and collects from property passing in the probate estate. There are certain situations in which the state will not take the residence, such as when there is a surviving spouse or disabled child.

What is the Detriment to the Client With This Planning? To overgeneralize, many planning strategies involve, at least to some extent, some pain, such as loss of control or expenditure. This may consist of some loss of control such as placing a home in "life estate" or assets in an "irrevocable trust." Planning may also involve spending money, such as when long-term care insurance is purchased.

Clients Will Not Necessarily Proceed With This Planning. Some clients will sometimes change their mind and decide *not* to proceed with advanced planning upon learning that the state will not forcibly take their assets (or that they can keep more assets than they expected, that certain assets would be foreclosed upon only at death, and the potential "pain" to engage in this type of planning,

Regardless of what course of action is chosen by the client, it should all be memorialized in a letter to the client. These topics are complex, and this area perhaps more than any other can fall prey to the selective memory of the client. If a client comes back to the office in crisis mode on the verge of a nursing home stay without this planning in place, you certainly want to have contemporaneous notes a letter in the file where all of the options were spelled out to the client.

<u>Some Clients Will Want to Aggressively Plan.</u> On the other hand, providing a legacy for children is a powerful motivator for some clients. The risk of not passing an inheritance to heirs is unacceptable to them, and they will be *willing to sacrifice, during their lifetime, to put more in their children's pockets*. (Incidentally, when I am explaining these concepts, I try to point out that most of the strategies done in a non-crisis (or pre-planning) mode do very little *in a material sense* for the client doing the plan. What it does provide for the client doing the planning is *peace of mind that their children will receive an inheritance.*)

<u>#2 KNOW WHAT IS A COUNTABLE RESOURCE AND WHAT IS NOT</u>

If you want the state to pay for your care, you have to conform to the rules set up. Before paying for benefits, the state requires the applicant to only have a certain amount of assets. The amount of assets varies depending on whether the applicant is married or single. For the married applicant, assets of both spouses are looked at, and each spouse is only allowed to have so much, called the Community Spouse Resource Allowance, or CSRA. For a single applicant, unless *excluded* or *not available*, as explained below, the assets must be spent down to a pittance ($4,000).

<u>Resource.</u> Applicants' assets are referred to as "resources." Resources are defined as "…property which the applicant can use directly or convert to provide for his basic needs for food, clothing, shelter or medical care." This includes:

- Real property (also includes interests in land)
    - Examples: lot of land, life estate, remainder estate, mineral rights, easements, leaseholds.
- Personal property (essentially everything that is not real property)
    - Tangible- furniture, autos, jewelry, etc.
    - Intangible-stock, bonds, money accounts, etc.

“Countable” Versus “Excluded” Versus “Countable But Not Available”. Resources are then categorized as whether they are *countable* or *excluded*. If resources are countable, they must be further analyzed to see if they are *available*.

- A *countable* resource is a resource that is counted towards a resource limit. Countable resources are available to the recipient, and are not excluded.

- An *excluded* resource is a resource that is not counted toward the resource limit because of a *specific exclusion*. (Some resources are totally excluded regardless of value (e.g. automobile used for transportation for medical care); some resources are excluded to the extent they do not exceed a specified threshold amount (e.g. a certain amount of the equity of the home of a recipient.)

- Even if a resource is countable, it *might not be available*. For instance, an individual may own a partial interest in a piece of property that is jointly owned by others, none of whom are willing to sell. (Steps must be taken to show that the others are not willing to sell.)

- Even further analysis must be undertaken to determine certain rules that apply to certain assets. For example, a jointly owned bank account is presumed to be 100% owned by the applicant (but this can be rebutted); whereas a jointly owned mutual fund is presumed to be owned proportionately with the other owners. Another example would be retirement assets, which are not a resource “when eligible for periodic retirement benefits (monthly, quarterly payment, etc.)”

Some Examples of Excluded Resources. In determining eligibility the following resources are excluded:

(1) The home and associated land up to the equity value of $506,000

(2) Household goods and personal effects, regardless of value

(3) One Automobile

(4) Life insurance, with a face value of $4,000

(5) Irrevocable burial contracts or irrevocable burial trust

(6) Funds set aside for burial, up to a maximum of $1,500

(7) Resources necessary for self employment (this could be tools of the trade, perhaps a family business, or rental property)

(8) Resources disregarded due to payments to a nursing home under a qualified state long term care insurance partnership policy

<u>Know What You Can Keep.</u> For a single applicant, countable resources cannot exceed $4,000. For a married applicant, the healthy spouse (called the *community spouse)* may keep the Community Spouse Resource Allowance, or CSRA, which ranges from $21,912 to $109,560; the applicant (called the *institutionalized spouse)* may keep $4,000.

The CSRA is essentially one-half the countable assets. When one spouse becomes institutionalized, there is a "snapshot" of assets. This snapshot dictates how much the CSRA is.

<u>Some Examples-Single Applicant:</u>

Mr. Jones, single applicant-

Residence: $400,000 (HELOC $50,000)

Bank Accounts: $20,000

Mutual Fund (owned jointly with daughter): $50,000

Auto

Mr. Jones' assets would be categorized as follows:

Residence = Excluded

Bank Accounts = Countable

Mutual Fund = Countable (but only ½)

Auto = Excluded

To qualify Mr. Jones for benefits, we might do the following:

1. The HELOC might be paid off with the bank account (leaving a balance of $30,000 (See above, $50,000 - $20,000 = $30,000)
2. The daughter's ½ of the mutual fund might be transferred to her (leaving $25,000 in the mutual fund)
3. The remaining $25,000 mutual fund liquidated, a burial plan could be established, and the remaining amount could be spent down on the HELOC, and Mr. Jones would qualify.

   **Spend-downs can occur in many forms. Debts can be paid, burial accounts can be set up, repairs can be done to the residence, lawyers can be paid, and qualifying annuities can be purchased and promissory notes executed.*

What if Mr. Jones is married, how much could he and his spouse keep? Here we would have to determine the Community Spouse Resource Allowance, or CSRA. We might want to take steps prior to the asset "snapshot" upon institutionalization to increase the CSRA. This might look as follows:

1. The house is exempt
2. Note that here we might tap into the HELOC to maximize the amount of the CSRA-assume that the HELOC is drawn upon to the extent of $200,000.
3. The daughter's ½ of the mutual fund might be transferred to her without penalty (leaving $25,000 in the mutual fund).
4. At this point the countable assets would equal $250,000 ($200,000 from HELOC, $25,000 remaining mutual fund, $25,000 bank account). This would establish the *"spousal share" at $125,000.*
5. Once the "spousal share" is determined, we can determine the CSRA; which is equal to $21,912 *or* the spousal share, up to a maximum of $109,560.

6. Because spousal share is greater than $109,560, we have "maximized" the CSRA.
7. The assets greater than $109,560 now need to be paid back to the Bank to pay down the HELOC prior to the application for benefits. If these amounts were *not* paid back, then the application would be rejected for being over assets.

#3 KNOW THE TRANSFEREE EXCEPTIONS

Under most circumstances a gift will result in a penalty. However, there are certain transferees to whom gifts can be made that will not result in a penalty. This can really save the day in a crisis situation.

For example, assume an elderly individual with one disabled child is on the verge of a nursing home stay. This client could establish a supplemental needs trust for this child, and transfer assets to the trust without a transfer penalty.

In another example, assume a client has been cared for by many years by her child. This child has provided extensive assistance to the parent, and has allowed the parent to remain in the community when she otherwise would have required nursing home care. This child qualifies as a "caretaker" child, and the client can transfer the house to her without penalty. (Need proof of child's residency and care.)

A third example, assume our client is single and has lived with his brother for years in what was the family homestead. Each brother has an equity interest in the house. Our client could transfer the residence to the brother without penalty.

I like keeping a list handy when I do an intake. I make a conscious decision to check off these "exempt transferees" to make sure I am not overlooking anything. The exempt transferees are the following:

The transferred resource was the individual's *HOME* and title to the home was transferred to:

- the individual's spouse;
- a child of the individual who is under the age of 21, or is blind, or permanently and totally disabled (as set out in the Regulations);
- a sibling of the individual who has an equity interest in the home and who resided in the home for at least one year immediately prior to the institutionalization of the individual;
- a son or daughter of the individual who was residing in the home for at least two years prior to the parent's institutionalization; and can demonstrate that s/he provided care to the parent which prevented the parent from entering an institution for the two year period (this is the so-called "caretaker child" exemption and is extremely useful).

For assets *other than the home*, one can transfer without penalty to:

- The spouse, or to another for the sole benefit of the spouse,
- The individual's child who is blind or permanently and totally disabled, or to another for the sole benefit of such child, or to a trust established for the sole benefit of such child,
- A trust established for the sole benefit of an individual who is under the age of 65 and permanently and totally disabled (as defined in the Regulations)
- The individual can prove his/her intention was to receive fair market value or other valuable compensation/consideration. (Here, would have to show failed attempts to dispose of the asset for fair market value.)
- The individual can prove his intention was exclusively for some purpose other than to qualify for Medical Assistance. (For instance, one makes a gift and then suffers an unexpected injury that causes a nursing home stay.)

<u>Fair Market Value Transfers.</u> Annuities can be purchased and loans can be made for fair market value. These transactions can change the character of the assets. What was perhaps a countable asset, now is gone and in its place

in Medicaid's eyes is an income stream (as annuity payments or loan re-payments).

#4 KNOW WHAT OPTIONS MIGHT BE AVAILABLE IN A CRISIS SITUATION

Asset Conversion. Keep in mind the power of asset conversion. This is simply spending otherwise countable assets on things that are exempt. For instance, home repairs, a new car, personal property, burial arrangements, etc.

Concept of the Discount Rate. The private pay rate for nursing homes is about one-third higher than the subsidized rate. This is an important concept to keep in mind. Consider, for example, a client who has done no planning and has a house. Is it better to sell the house, and pay the nursing home until the money runs out; or is it better to hold the house until death and have the house foreclosed upon after death? On these facts alone*, it might be better to hold the house. Why? Because even though the house will be foreclosed upon, the amount accruing against the house will be at the Medicaid rate (1/3 less than the private pay). Looked at another way, it makes the assets last longer. If death occurs before the lien overtakes the equity in the house, assets may be saved.

(Note that this is example is provided to show the concept; this is not necessarily the planning that would occur with the house.)

The Part Gift, Part Loan Scenario. What can be done when a client is over assets and has not done advanced planning? One might consider using annuities or promissory notes in conjunction with a gift, to save part of the remaining property. This is a sophisticated planning technique that cannot be fully explored here, but an example will help understand the concept.

For instance, assume a client has $46,662. Further assume that the nursing home monthly rate and the penalty divisor are equal, at $7,777. Our client, rather than simply spending down his money, could consider a qualifying annuity or promissory note.

The client would give away $23,331, and loan an equal amount through a qualifying promissory note. The promissory note would pay back over 3 months. At this point, the client would be "out of assets" and would apply for benefits. Of course, the benefits would be denied because of the gift of $23,331. The penalty would last 3 months. The promissory note or annuity would pay back over this time period to cover the nursing home bills. At the end of the 3 months the client could get Medicaid coverage. The net effect of this is that $23,331 was saved as opposed to spending down all but $4,000.

<u>Consider Life Estate Deeds With Retained Interests.</u> This might save the house. Consider a client who has a residence in his name alone. The client is on the verge of a nursing home stay. Consider having this client put his residence in life estate will the power to re-vest ownership in his name. This is not a disqualifying gift (because he has not completely parted with ownership). The house should still be an exempt asset, which will avoid probate (and probate lien) at death.

#5 THE GIFT TAX LAWS VERSUS THE MEDICAID GIFTING RULES

First, a primer on the gift tax laws. Every person has a "freebie" from the IRS, in that they can make what are called "annual exclusion" gifts. These annual exclusion gifts are presently $13,000 per year. Essentially the law allows an outright gift to be made to any person, once per year. These gifts do not have to be reported to the IRS, they are "under the radar," so to speak. A gift to a person above this amount in any one year needs to be treated differently.

Assume you make a gift to a person of $20,000 in the year 2011. The overage of $7,000 would need to be reported on a Form 709 (US Gift Tax Return), so the IRS can keep tabs on how much you have gifted during life. But filing a gift tax return does not necessarily mean that a tax will be due.

Presently this overage eats into a lifetime "credit" of $5,000,000. Using the example above, after the $20,000 gift was made, the remaining gift tax "credit" would be $5,000,000 less $7,000 (the overage of $20,000 less the annual exclusion amount of $13,000), or $4,987,000.

This may play out as follows: A client comes in with a house worth $300,000 and portfolio assets of $400,000 and states, "I have been making gifts of $10,000 per year to my children. I don't want to gift more because I don't want to pay a tax." What this client needs to know is, that if he wanted to, he could give his whole estate away immediately without having to pay a gift tax. Why? Because even though this lumped gift may exceed his annual exclusion amount of $13,000, he has more than enough unified credit to cover the overage.

Following up on the same example, sometimes the client will say I do not want to gift more than $10,000 because I do not want the recipient to pay an income or gift tax. Again, this is not an issue our client needs to worry about. Recipients of gifts receive them income tax free.

So, we can conclude that for most people, gifting assets will not cause gift tax or income tax recognition. So should the gift be made? In an elder law context, here is where the rubber hits the road.

<u>Control.</u> I believe the starting point when analyzing gifts needs to be control. Clients need to be counseled on how gifts are permanent. I have seen seniors deprived of investable assets and houses. A common scenario is that a senior will come in and state "I want to give everything away now." This client needs to be strongly advised that once the gift is made, the assets are now subject to the recipient's issues, which may be: divorce, bankruptcy, death, disability, or even disfavor with the parent. All of these can leave the parent cash poor or without a residence, and at an extreme disadvantage.

There are ways to combine the strategy of making gifts, while still preserving safeguards and some level of control for seniors, such as irrevocable trusts and retained life estates.

<u>The Concept of Tax "Basis."</u> Clients need to be counseled on what happens with tax basis when gifts are made, and what happens with tax basis when they die. Adjusted basis is the measuring point used to determine what capital gains are due when property is sold. For instance, a person purchases a share of IBM stock for $10. This is his basis. Five years later, he sells it for $100. The capital gain upon which taxes must be paid is determined by the difference of the selling price of $100 less the cost basis of $10, or $90.

When an outright gift is made, the recipient receives the same basis as the transferor. This is called a carryover basis. Using the example above, rather than selling the stock, our client gives the stock to his son, and the son sells it. The son takes the IBM stock with the same tax attributes as the father, and must pay capital gains on the $90 of gain.

But what if our client retains the stock until he dies? What happens to the stock basis then? Upon death the stock enjoys a "step up" in basis, to its value upon our client's death. Now our client's son upon receipt of the stock can sell it and pay no capital gains.

<u>Keeping Some "Strings" to a Gift May be Good for Medicaid Planning.</u> Knowing this can help clients. The body of knowledge regarding gifting is cemented on the concept of making the gift "complete." In other words, in a tax world, it is considered a mistake to make a gift with any retained "strings" such as the power to enjoy income from the gift, or control where the gift is going. In a tax world keeping these "strings" causes the gift to remain in the person's taxable estate, where bad death tax results occur.

On the contrary, oftentimes our clients who are trying to protect assets from nursing home costs, have no concern whatsoever about death taxes simply because their estates are not large enough ($859,350 in Rhode Island).

For these clients, we can intentionally cause the gift to "fail" for tax purposes, but have the gifts be "complete" for asset protection purposes. Some ways to do this are (1) retaining an income (not principal) right in an irrevocable trust, (2) retaining a life estate in a personal residence, (3) retaining a special "power of appointment" in an irrevocable trust (the power to steer where property is going when you die-but not to yourself, your estate, or the creditors of your estate).

So, continuing with our example, our client wants to protect his share of IBM stock from nursing home costs. His estate is not large enough to be hit with an estate tax or gift tax. We could advise him to put the IBM stock into an irrevocable trust, and keep the income from it. Our client's share of IBM would now be protected from nursing home costs, and upon his death when the trust distributed out to his son, his son would receive the IBM stock at its date of death value and the son could sell it without capital gains.

The 5-Year "Look-Back" Period and Resulting Penalty. Much confusion still exists over how the 5-year look-back period works, and the resulting penalty if a gift has been made within that time. The Deficit Reduction Act implemented a 5-year look-back period. I think the best way to conceptualize how this works is to think of the Department of Human Services as having a flashlight. The beam of this flashlight "looks back" five years prior to an application for Medicaid benefits. (When the application is submitted, 5 years of prior financial statements are analyzed, and the applicant is questioned as to whether gifts have been made.) If a gift has been made 5 years prior to the application, a penalty applies.

The length of the penalty is determined by dividing the size of the gift by the average cost of nursing home care. So, to keep the numbers simple, say the average cost of nursing home care each month is $5,000. Further assume that a client made a $50,000 gift four years before applying for Medicaid. A penalty of 10 months would apply.

This regime requires a longer time in which a person needs to "stay healthy" after a gift is made, but also changes (for the worse) the application of the penalty. The penalty now applies so that it begins to run only when the applicant's money has "run out." At that point, the person is in the nursing home with no money, and the state is unwilling to provide coverage.

Gifts can always be "cured" by returning the amount gifted. But if the gifted money was spent or otherwise disposed of (which happens with frequency), this penalty can be a treacherous problem.

Problems When Tax Concepts are Mixed With Medicaid Planning Concepts. Consider the client who mistakenly believes that "annual exclusion" gifts are not only freebies for tax purposes, but freebies for Medicaid purposes as well. Every time the client makes the $13,000 gift to his children he is in a sense "re-setting" the clock as far as the 5-year look-back period is concerned. If the client does this until a nursing home stay is required, the gifts will have to be returned or the client will suffer from the penalty to be imposed.

Misconceptions also may deprive clients of some important controls with respect to their property. If we have established that estate and gift taxes are not going to be a problem, then we can, for the client, retain several powers that are beneficial to the client but would have problems on the tax side. Such powers that can be retained (usually in the context of an irrevocable trust) are retained rights to income, the power to hire and fire trustees freely, the power to direct where the assets are to go at death (a so-called special power of appointment). These powers are essentially "sticks" in the "bundle of rights" that we can retain for the client while still having the gift be complete for Medicaid purposes.

An added benefit to keeping some of these rights (such as retained income and the special power of appointment) is that upon death, because of the retained income interest (retained income) or the incomplete nature of the gift for *tax purposes only* (retained special power of appointment), the *tax basis* of the property enjoys a step up at death. This enables the recipients of the property to sell the property without capital gains at death.

#6 PUT EXTRA THOUGHT INTO THE POWER OF ATTORNEY

In an elder law context the general durable power of attorney (or "power of attorney") becomes an incredibly useful document. However, it is frequently inadequately provisioned, which can cause problems. Additionally, thought needs to be put into when the power of attorney "comes online" so as to avoid any mischief if the client has any reservation whatsoever regarding the integrity or competence of the appointed attorney-in-fact.

<u>Use in "Crisis" Mode.</u> There will be clients who never do proactive planning. These clients will appear on the eve of a nursing home stay, and will seek counseling on what type of last minute planning can be done.

In these cases, the power of attorney can be a great tool to reposition assets. For instance, assets may need to be shifted from one spouse to the other in a so-called "inter-spousal transfer," which can be done without a corresponding penalty. Similarly, powers of attorney can be used to make gifts to others: perhaps a sibling with an equity interest in a residence, or a disabled child.

<u>To accomplish these transfers, the power of attorney must contain appropriate gifting powers.</u> These gifting powers might be "wide open," or they might be more restrained. For instance, the power to gift might be limited to only the spouse or disabled children (both of whom can be the recipients of gifts without penalty).

Failure to provide such powers may result in a court procedure in which a court appointed representative is empowered to make such transfers. Such a proceeding may take a long time, incur significant costs, and perhaps might be denied by the court.

<u>For tax and other reasons, powers of attorney sometimes contain gifting provisions that are restrained or qualified.</u> For example, a power of attorney may contain a gifting provision that allows gifting to be made, but only if *to issue in the same proportions as set out in my will dated* …Or, sometimes a power of attorney will provide the attorney in fact with the ability to make gifts, *but such gifts shall be limited to "the annual exclusion amount"* or to such other limit such as "*$5,000 or 5% of my estate.*"

Perhaps the way to approach the preparation of a power of attorney for a client without any estate or gift tax issues, but who may have a Medicaid issue, would simply be to draft the power of attorney with a completely wide open gifting power such as: *My attorney-in-fact shall have the ability to make gifts of any amount, at any time, of any type, to any person or trust for any person, including my attorney in fact.*

Of course, this is putting awesome powers into the attorney-in-fact's hands. When designing a power of attorney, the client should be educated about how the power of attorney might be used, and asked whether the client feels comfortable adding in these "powerful" powers to the document.

<u>If the client expresses any reservation, then methods might be discussed as to how to restrain the attorney-in-fact's use of the document until the time it is needed.</u> One way might be to draft the power of attorney as a "springing"

power of attorney. A springing power of attorney "springs" into life upon some defining moment of incapacity.

One drawback with a springing power of attorney, however, is that these documents sometimes face scrutiny at the time they are to be used. For instance, one may present the power of attorney at a bank, only to discover that the bank will not honor the document without a court order declaring incapacity. This extra time proving up incapacity can be a nettlesome issue in a time of crisis, when assets need to be repositioned quickly.

The problems with a springing power of attorney can be minimized through appropriate language in the document. For example, the power of attorney might contain the following language, which allows the document to spring into life relatively quickly:

> The authority granted to my Attorney-in-Fact under this power of attorney will only become effective if I am incapacitated or I have executed a *Certification of Authorization by Principal* as provided below.
>
> I am incapacitated, for all purposes of this power of attorney, in any one of the following circumstances:
>
> I am incapacitated whenever, in the opinion of two licensed physicians, I cannot effectively manage my property or financial affairs due to age, illness, use of prescription medications, drugs or other substances, or any other cause.
>
> I am restored to capacity whenever my personal or attending physician provides a written opinion that I can effectively manage my property and financial affairs.
>
> I voluntarily waive any physician-patient privilege or psychiatrist-patient privilege that may exist in my favor and I authorize physicians and psychiatrists to examine me and disclose my physical or mental condition to my Attorney-in-Fact for purposes of this power of attorney.
>
> I am incapacitated if a court of competent jurisdiction declares me disabled, incompetent or legally incapacitated.
>
> If I have executed the *Certification of Authorization by Principal* attached as an exhibit to this power of attorney, then the powers granted to my Attorney-in-Fact under this power of attorney shall be immediately and fully effective.

In a time of crisis, the power of attorney could be activated by the Certificate, if the principal is able to sign. Alternatively, the doctors' opinions could be obtained.

Another way to secure the power of attorney is to draft it to be effective immediately, but to provide an escrow agreement to the law firm to retain the document until the appropriate time. The body of an escrow agreement to the law firm might read:

> I instruct my attorney Michael T. Lahti, of Lahti, Lahti & O'Neill, LLC to hold my Power of Attorney signed this ___ day of June, 2011, until such time my attorney deems appropriate, or until I revoke said document, whichever shall first occur. My attorney's discretion in this regard shall be absolute, and he shall be held harmless for any decisions made by him for retaining or releasing said document provided such actions were taken in good faith.

A corresponding HIPAA release to the attorney would be signed with the escrow agreement, so that the attorney could have access to client medical records for the purpose of determining the client's situation, and whether it warranted releasing the document. Such language in the HIPAA Release might read:

> I, Barbara M. Smith, an individual, hereby appoint my attorney, Michael T. Lahti, for the limited purposes of determining my capacity to make gifts, to execute estate planning documents and whether, and to what extent, a guardianship, conservatorship or other protective proceeding for me is necessary or desirable, as Authorized Recipient for health care disclosure under the Standards for Privacy of Individually Identifiable Health Care Information (45 CFR Parts 160 and 164) under the Health Insurance Portability and Accountability Act of 1996 ("HIPAA")

Perhaps another way to provide insulation against an attorney in fact making poor gift choices would be to include a comprehensive gifting provision, which requires gifts to the attorney in fact to be made by some independent party. Such a power might read:

> My Attorney-in-Fact may make gifts on my behalf, which may include gifting or otherwise spending down my estate for Medicaid eligibility and planning. I specifically authorize gifts to my Attorney-in-Fact, but only a Special Attorney-in-Fact may make gifts to my Attorney-in-Fact, in which case my Attorney-in-Fact, by unanimous vote if more than one Attorney-in-Fact is serving, shall appoint a Special Attorney-in-Fact unrelated by blood or marriage to any Attorney-in-Fact to review the facts and circumstances and to decide whether such gifts should be made. I recommend, but do not require, that my Attorney-in-Fact select an independent certified public accountant, attorney-at-

law, or corporate fiduciary to serve as the Special Attorney-in-Fact under such circumstances.

Neither my Attorney-in-Fact, nor the Special Attorney-in-Fact appointed by my Attorney-in-Fact, shall be liable to any beneficiary for exercising or failing to exercise its discretion to make gifts.

Other Powers to Consider. I like to put a comprehensive power regarding government benefits in my powers of attorney. Such a power might read:

Power Regarding Government Benefits.

All powers described in this Section are exercisable with respect to all federal and state (or any subdivision thereof) programs existing when this power of attorney was executed or for which I become eligible after this power of attorney is executed. The power of attorney shall extend to any state in which I live when my Attorney-in-Fact's powers become effective.

My Attorney-in-Fact is appointed as my "Representative Payee" for the purposes of receiving Social Security benefits. My Attorney-in-Fact may collect all benefits payable to or for my benefit by any governmental agency or body, such as Supplemental Security Income (SSI), Medicaid, Medicare, and Social Security Disability Insurance (SSDI). My Attorney-in-Fact shall have the full power to represent me and deal in all ways necessary concerning rights or benefits payable to me by any governmental agency including, without limitation, Supplemental Security Income (SSI), Medicaid and Social Security Disability Insurance (SSDI).

My Attorney-in-Fact may:

Execute vouchers in my name for allowances and reimbursements payable to me by the United States, a foreign government, a state, or a subdivision of a state to me, including allowances and reimbursements for my transportation, children's and other individual's customarily or legally entitled to be supported by me, and for shipment of their household effects.

Take possession, remove and ship any of my property from a post, warehouse, depot, dock, or other place of storage, whether governmental or private, and execute and deliver a release, voucher, receipt, bill of lading, shipping ticket, certificate, or other instrument for that purpose.

Prepare, file, and prosecute my claims for benefits or assistances, financial or otherwise, for any claim to which I am entitled under a statute or government regulation.

Prosecute, defend, arbitrate, settle, and propose or accept a compromise with respect to any benefits I may be entitled to receive.

Receive the financial proceeds of any type of claim described in this Section and invest, disburse, or use the proceeds on my behalf for any lawful purpose.

Sign on my behalf any document necessary to permit my return to my residence following my incapacity or other condition that prevents me from currently living there.

Execute any trust agreement described in 42 U.S.C. § 1396p (d)(4) with any trustee or trustees that my Attorney-in-Fact selects. In addition, my Attorney-in-Fact may deliver and convey any or all of my assets to the trustee or trustees of the trust as well as designate the trust as payee of any income to which I may be entitled.

For a married couple in crisis mode, perhaps the most useful power, in conjunction with a gifting power, is the Power to Deal With a Spouse. Such a power might read:

Power to Deal with My Spouse

If I am married, my Attorney-in-Fact may deal with my spouse on my behalf. In dealing with my spouse, my Attorney-in-Fact may partition, transfer and exchange any of my marital property estate, whether separate or community property between my spouse and me. My Attorney-in-Fact may enter into and execute on my behalf marital property agreements, partition and exchange agreements or community property agreements or may enforce, amend or revoke any marital property agreement between my spouse and me but only with respect to rights in and obligations with respect to property owned by my spouse, by me or by both of us and with respect to reclassification of management and control over our property.

#7 LONG TERM CARE INSURANCE

Rhode Island has established a Qualified Long Term Care Insurance Partnership program. The program provides "for the disregard of an applicant's resources in an amount equal to the benefits paid by the policy as of the time of the application for assistance." This allows one to retain more assets than would otherwise be allowed.

Notwithstanding the above, I have found long term insurance to be very helpful in times of crisis. When one is in a nursing home paying thousands of dollars each month, having a source of liquid funds coming in can save the day. Not only does this sometimes prevent the liquidation of assets, but it has the palliative effect of reducing anxiety for the family.

For younger clients who really want to be proactive, I will have them price out long-term care insurance. Sometimes the client will purchase a policy with a 5-year benefit.

This 5-year benefit under the long-term care policy allows the client to maintain control of his assets. The client will also have peace of mind, that if he ever has to give away assets, the long-term care policy will provide cash needed for the client to make it though the 5-year look-back period.

8 THE IRREVOCABLE TRUST

When appropriate. The irrevocable trust is usually a viable option for clients who still want to protect assets from nursing home costs after: (1) being educated on their exposure is, (2) know what assets the state will require to be spent down, and what the state might take upon death, and (3) the detriment to the client to engaging in this type of planning.

Flexibility. The irrevocable trust is a very flexible tool in this context. Properly drafted the trust can provide the client with:

- A significant amount of retained use and enjoyment of the corpus.
- Protection from nursing home costs.
- Creditor Protection.
- Income tax benefits, such as an at-death "step-up" and the capital gains exclusion provided under Code Sec. 121 ($250,000).
- The ability to provide estate tax planning. (For instance, each spouse would set up an irrevocable trust that would purposefully not qualify for the marital deduction.)

Acceptable Powers. The irrevocable trust can be set up so that the client can keep:

- Lifetime income.

- Use and Occupancy.
- A Retained Special Power to Appoint the Property (the ability to appoint to persons other than the client, the client's estate, or the creditors of the client's estate).
- Trusteeship (Note: I prefer *not* to put my clients on these trusts if they are comfortable doing so. I am concerned that keeping too much control may cause inclusion at some point.)

<u>Bad Powers.</u> The irrevocable trust should be set up so that, *under no circumstance*, *can principal of the trust be distributed back to the client*. The ability to distribute principal back to the client would cause the trust to be countable. (Note-every provision inside the trust needs to be reviewed carefully. Read and then re-read the document. For instance, typical boilerplate trustee powers such as the powers of the trustee to determine what is income and what is principal could be fatal to a trust where the client retained an income interest.)

<u>"Trap Door" Provision.</u> Consider placing a mechanism inside the irrevocable trust to allow assets to be distributed from the trust during the client's lifetime. This could prove useful in the following situations:

- Client does not stay well as long as expected. To avoid a penalty, assets need to be returned to client. The trust could drop assets down to a child or children, who could then distribute the assets back to the client.
- The client wants some or all of the assets back. For instance, say a house inside the trust was sold, and replaced with a smaller house. The client wants the surplus sales proceeds. The trust could distribute the extra proceeds down to the children, who could then transfer them back to the client.
- Extra assets are needed to pay for care. For instance, say a client has placed his portfolio inside the irrevocable trust, but fell ill 4 ½ years later. The trust could distribute enough assets down to the children, who could pay the nursing home costs for the remaining 6 months and 1 day to get the client beyond the 5-year period.

<u>Protective Mechanisms.</u> If the client is not the trustee, I like to put protective mechanisms inside the trust to prevent the children from

depriving the parents of the property inside the trust. Such mechanisms can include:

- Use of a Trust Protector to approve all sales of real estate.
- Use of a Trust Protector to approve of all principal distributions from the trust during client's lifetime.
- Providing the client with a power to appoint the corpus (perhaps to charity disinherit children, or to change which child gets what).
- Provisions inside the trust retaining use and occupancy of all real property for client.

#9 WILL CONTAINING TESTAMENTARY SNT FOR SPOUSE

A powerful strategy to consider is a will *containing a testamentary trust* for the surviving spouse. This might be used for the married couple who are doing late planning.

For instance, clients come in without having done any prior transfers. One spouse is very sick. Assets could be transferred *to this spouse*. Upon his death, assets would be held in a testamentary trust for the benefit of his spouse.

The testamentary trust would be managed by an independent trustee (for instance a child), and the trust could be drafted with either supplemental needs provisions, or, alternatively, as a purely discretionary trust (with the trustee having complete discretion as to what is distributed).

This mechanism can protect assets from the surviving spouse's nursing home costs, while still providing for the surviving spouse.

Coordinate With the Power of Attorney. The power of attorney should be coordinated with this strategy, so that assets can be repositioned quickly. For instance, if one spouse is ill and about to die, having a power of attorney that allows the attorney-in-fact to quickly re-title assets is essential. (See provisions, above, for sample language.)

#10 BE ETHICAL

Healthy Client. Practicing in this area requires diligence in the area of ethics. For the client who comes in healthy and competent, and enthusiastic about protecting assets, the client needs to go through an educational process on what the detriments to him might be (loss of control, etc.).

Sick Client. For the client who comes in in crisis, this becomes more pronounced. Be aware of clients coming in with children. (Note, having the children there is not a bad thing per se. But beware of a child who appears to be the "driver" of the appointment. Do not hesitate to ask the child to leave, or to schedule a follow up appointment without the child, so that the parents' answers can be obtained.)

Fully explore competence issues, and ask detailed questions as to family relationships, especially when powers of attorney with broad powers are involved or where a disproportionate amount is being distributed to one child.

Use your intuition; if something does not "feel" right at the appointment, it's probably not.