Irrevocable Trusts:
An Effective Medicaid Planning Tool
by Gary R. Villnow, II

The potential costs associated with long term care are a concern that becomes common to individuals as they age. As a result of this concern, many individuals seek strategies that will protect their assets against the costs associated with long term care and allow the passage of those assets onto their heirs.

Most strategies calculated to protect assets against the costs of long term care involve making assets unavailable to the individual for the purpose of paying the costs of long term care. According to current Medicaid rules, assets must be made unavailable for a period of five years prior to eligibility for long term care benefits. If assets are made unavailable within the five years prior to making a request for long term care benefits, there will be a period of time when the individual cannot receive benefits.

Despite the fact that many individuals are interested in planning for long term care needs, they may be generally reluctant to transfer assets to children or other family members for fear of relinquishing control over them. Other problems may also arise as a result of transferring assets to children or other family members. Those problems include: the loss of some tax advantages, the requirement of filing a gift tax return, and subjecting assets to the claims of the recipient's creditors or spouse in the event of a divorce.

The concerns associated with transferring assets to children or other family members result in procrastination or inaction, thereby subjecting the individual's assets to increased risk.

Individuals who are interested in planning for the costs of long term care may wish to consider transferring assets into an irrevocable income-only trust.

The transfer of assets to an irrevocable income-only trust renders assets unavailable to the individual who transferred the assets into the trust, but allows the individual to retain all income earned by the asset.

The term "irrevocable trust" is commonly associated with the relinquishing of control, inflexibility and rigidity. However, an irrevocable income-only trust will enable an individual to retain a significant degree of control over the assets held by the trust, while at the same time protecting assets from the costs associated with long term care. In addition, these trusts reduce the risks associated with transferring assets to children or other family members, provide tax advantages to the children, avoid the necessity of filing gift tax returns, and ensure that the assets can be returned to the person who creates the trust if that should become necessary.

In order to utilize an irrevocable income-only trust, couples or individuals may transfer all or a portion of their assets into the trust. These individuals or couples are generally the grantors of the trust as well as the trustees. As trustees, the individuals or couples creating the trust retain the ability to make distributions of income from the trust to themselves. The trustees also retain a significant degree of control over the assets transferred to the trust, including the ability to determine how assets are invested, when to sell or replace an asset, including the house or other real estate.

Insofar as annual income taxes are concerned, any interest received may be reported on the grantor's individual income tax returns. The grantors will not be required to file a separate trust tax return or pay trust tax rates.

Because the irrevocable income-only trust is considered a "grantor" trust, no gift tax return is required at the time transfers are made to the trust.

Upon the death of the individual who created the trust, the assets held by the trust may pass to heirs as directed by the grantors without the need to submit the assets to the probate process, nor will the assets be recoverable by Wisconsin's estate recovery program, which is a program mandating payment of a person's estate to the state in an amount equal to the benefits paid on the person's behalf.

Additionally, current IRS rules allow for a significant income tax benefit known as a step-up in basis, which serves to eliminate or greatly reduce capital gains upon the sale of property received by the trust beneficiaries after the death of the grantors.

The flexibility involved with the utilization of the irrevocable income-only trust, coupled with the retained tax advantages and benefit received as a result of protecting assets, lead to the conclusion that the use of an irrevocable income-only trust for long term care benefits purposes is an attractive option for many families.

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