TITLE: Use of Asset Protection Trusts in Long Term Care Planning

This article is going to discuss Irrevocable Asset Protection Trusts and the use of those trusts in long term care planning. Such trusts are methods for families to protect assets from expected or unexpected long term care costs. It is commonly used with senior clients and others expecting future long term care costs.

This is not your typical, revocable trust—it is not a trust that can be amended or revoked.

DEFICIT REDUCTION ACT (DRA)
In February of 2006 the President signed the deficit reduction act of 2005 (DRA) which was a profound change in Medicaid and changed key Medicaid requirements. One of the key changes was a modification of the “look back” from three years to five years. Thus, if you apply for Medicaid, the Medicaid officials can “look back” at the transactions that you made for the last five years.

If so, then these gifts create a penalty delaying the Medicaid qualification. Additionally, this penalty does not begin until the applicant would have qualified for Medicaid (in the nursing home and out of money).

The result of the legislation is to encourage long term care planning.

ASSET PROTECTION TRUST
Asset Protection Trusts have been in use for many, many years. Initially they were used as a way to protect assets from creditors. They were the favorite of doctors and other people who had a high risk of being sued.

Asset Protection Trusts were also used to protect against the possibility of high taxation. The Asset Protection Trust were a method where by property could be transferred away to the trust and help avoid high estate taxes at the time of death. Some of the trusts contain nothing more than insurance policies that would payout tax-free benefits to the beneficiary, to help the beneficiary pay taxes on the beneficiary’s inheritance from a family member.

ASSET PROTECTION TRUSTS AND LONG TERM CARE PLANNING
In our office we use two basic types of trusts for long term care planning. One is a Medicaid Asset Protection Trust (MAPT) and the other is a Veterans Asset Protection Trust (VAPT). They differ in only one significant regard. In the MAPT, the person setting up the trust can continue to receive the income. In the VAPT, the person setting up the trust does not receive the income.

Otherwise the basic designs are the same. Both are considered irrevocable grantor trusts designed to receive a “gift” from the grantor. The Asset Protection Trust can provide the grantor a stream of income over their lifetime (in case of a MAPT); however, any assets transferred to the Asset Protection Trust are no longer available to the grantor. So the future Medicaid applicant makes a gift of these assets to the trust in turn for an expected income stream.
Other key parameters of a MAPT are:

- **MAPT Trustees** – This individual is selected by the grantor. The trustee has responsibility to manage the assets of the MAPT for the benefit of all the beneficiaries. Typically, the MAPT trustee is a family member but it can also be a third party company. It should not be the grantor.

- **Lifetime Beneficiaries** – These beneficiaries can receive distribution of principal from the trustee during the lifetime of the grantors. Often they are the children of trust grantor. Once a distribution is received by the lifetime beneficiaries they can use it as they choose. If the trustee is also a lifetime beneficiary, then there are safeguards that we put into the trust so the trustee cannot just empty out the trust to him or herself.

- **Residuary Beneficiaries** – These are the beneficiaries that will receive whatever is left in the trust on the death of the grantor.

**MAPTS AND MEDICAID PLANNING**

MAPTs are used as a proactive planning to “gift” assets into a trust. These assets provide an income stream and will no longer be an available resource for the future Medicaid applicant. The trust is drafted in such a way that the principal cannot be distributed to the grantor—thus lies the protection. If an individual is able to combine their long term care insurance, gifts from family members or other available assets to bridge the five year look back window, then this removes resources allowing the individual to protect assets from the increasing long term care costs. At the end of the five year window, the grantor applies for Medicaid. This can create an effective, proactive Medicaid asset protection planning strategy and MAPT resources are not recoverable by the State.

**TAX ADVANTAGES**

The MAPT provides some significant tax advantages over outright gifting. Because the grantor continues to receive the income, the income is taxed at the grantor’s income tax rate—usually a lower rate than the individual. Also by keeping the income, the grantor retains some significant control and peace of mind.

Secondly, the grantor retains some significant powers. Those powers include what is called a limited testamentary right of appointment. It provides that the grantor can change the beneficiaries among the grantor’s children, grandchildren, other lineal descendants, and the charitable organizations. The grantor cannot change the trust so as to benefit the grantor’s estate or creditors.

Not only does this give the grantor significant power, it also allows the grantor to retain enough power over the assets so that the assets can stay in the grantor’s estate for estate tax purposes. This allows for a “step up” in basis in the property. Thus assets that have appreciated since being acquired by the grantor will receive a step up in basis at the time of the grantor’s death—and very significant tax benefit to the beneficiaries. Compare this to an outright gift: if you give appreciated assets to a beneficiary, that beneficiary receives your basis (what you pay for the property) and when the beneficiary sells the property they are going to pay capital gains on all the profits.
VAPT PLANNING
VAPT has the same power with one significant exception. In the VAPT planning you do not get the income.

WHY USE VAPT PLANNING VERSUS MEDICAID PLANNING?
VAPT planning is used for those trying to qualify for VA benefits. The VA currently has a rule that allows it to look into the trust. Though the trust may provide you are not entitled to the principal, the VA still considers it an available resource. So a Medicaid Asset Protection Trust will not work in the case of a veteran trying to apply for benefits. However, a VAPT (where the veteran does not receive any income or principal) the trust will be effective and may allow for the veteran to qualify for benefits.

Otherwise, the VAPT has many of the same features as the MAPT: a step up in basis; ability to adjust beneficiaries.

VAPTs may be a valuable tool for those in a crisis that are trying to pay for assisted living costs or at home care and are not ready to spend down all of their assets before qualifying for Medicaid.

SUMMARY
VAPTs and MAPTs are great tools for long term care planning. Both have good features that will help the family preserve a business or farm.

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