David M. Frees: dfrees@utbf.com
Douglas L. Kaune: dkaune@utbf.com

Phone 610-933-8069
Fax: 610-933-3603

UNRUH TURNER BURKE & FREES

120 Gay St.
Phoenixville, PA 19460

17 West Gay Street
West Chester, PA 19380

346 East King Street
Malvern, PA 19355

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MEDICAID AND NURSING CARE PLANNING

GIFTING TO THE IRREVOCABLE TRUST

Special Points of Interest

- Asset Control
- Income Retention and Capital Gains Issues
- Children's Creditors
- Estate Planning

This is one in a series of articles covering the Medicaid, gifting and nursing home care issues. If an individual is considering gifting some or all of his assets to protect them from nursing care spending, he should be sure to obtain information on the most effective way to make such a gift. This article will discuss some of the benefits of making these gifts into an Irrevocable Trust rather than outright to an individual. A final decision can only be made after reviewing the specific facts associated with each transfer.

Asset Control: If you transfer any assets outright to your children they will no longer be your assets. For example, your children will be legally entitled to make any and all decisions relating to the upkeep, maintenance, or even the future sale of any real estate you place into their names. They will be able to make decisions relating to the use or investment of any monetary assets even if you disagree with the decisions. If you gift assets in equal shares to multiple children, you are only increasing the chance that one of the children may use assets improperly.

Conversely, a gift into an Irrevocable Trust will allow for the gifted assets to be pooled in one collection of assets during your lifetime. The assets are not placed into the names of your children. You still will not retain legal title to gifted assets, but it does allow you to select a trustee or trustees who are in charge of the assets during your lifetime. You do not have to appoint all of your children or any of your children as trustee. Therefore, if you have one trusted child or advisor, he or she can oversee the assets without the interference of other children. You can feel more secure that there will not be multiple variables affecting the investment or use of your assets during your lifetime. Additionally, you set forth the rules for how a trustee may use the assets during your lifetime.

Income Retention and Capital Gains Issues: At the time you make an outright gift the recipient will receive your tax basis in the asset. The recipient will therefore have to pay capital gains on the increase in the value of the asset since the time of purchase once the asset is sold. The recipient may not have to pay the PA inheritance tax, but may in turn pay a much higher capital gains tax. This is of particular importance in the case of highly appreciated stocks or real estate.

For gifts into trust, you may retain the right to receive the income from the trust during your lifetime while protecting the principal from your creditors. This will cause the trust assets to be includable and taxable in your estate for inheritance and estate tax purposes. The likelihood is that this would create a need to pay The PA inheritance tax where it may otherwise have been avoided. However, the inclusion of the assets could be desirable if there are low basis capital appreciation assets placed into the trust that could receive a stepped-up basis. A weighing of the relevant tax issues would need to be made at the time of the creation of the trust. Regardless of the tax issues, it may be preferable to retain the income flow if the giftor is in need of the payments for future expenditure. The retained income would also be payable to a nursing home should that type of care eventually be necessary.

Children's Creditors: If you make an outright gift and any of your children are sued in the future or incur large debts, their creditors (including divorce creditors) will be able to reach the value of that child's share of the gifted assets. The creditor could possibly force a sale of real estate even if you are still residing there. If you gift assets in equal shares to multiple children, you are again increasing the chance that a creditor can reach your assets during your lifetime.

A gift into a properly structured Irrevocable Trust will help provide protection from your children's creditor's during your lifetime. The Trust will create a protective shield because, in the eyes of the law, the gifted assets are owned by the Trust and not by the children. Therefore, their creditors have a much more difficult claim as to those assets. This will help to insure the assets are not lost during your lifetime.

Estate Planning: Making outright gifts to your children can cause a transfer contrary to the one set out in your last will and testament. If you make gifts to a child and that child passes away before you, it is likely that he or she would give the assets to his or her spouse and not directly to his children (your grandchildren). This could have two negative effects. First, you may prefer that your assets pass to your grandchildren rather than to your child's spouse. Secondly, if you were counting on your child using that money or asset for your benefit, you may not be able to count on this new beneficiary doing the same.

A gift into a properly structured Irrevocable Trust will help provide protection from your children's creditor's during your lifetime.

By making your gifts to an Irrevocable Trust you can insure that the Trust terms mirror those of your will. The assets would remain in one pool during your lifetime and be divided into equal shares for your beneficiaries only after you have passed away. The Trust would account for the possibility of one of your beneficiaries dying before you. The trust would also help insure that there will be sufficient assets to pay for the administrative and tax costs in your estate.

Conclusion: People are often shocked when they come to realize that what had initially appeared to be a simple transaction actually is very complicated. This article has only served to cover the benefits of making gifts into an Irrevocable Trust rather than outright to individuals. Before making the decision to gift assets to trust, you must determine if it makes sense for you to make a gift of your assets at all. You will have to review all of the pertinent tax, Medicaid application and asset control issues with your advisors prior to making that decision.