# PLANNING AHEAD:
# Asset Protection Trusts

## Why Plan Ahead for Long-Term Care?

Long-term care services are "a combination of medical, nursing, custodial, social, and community services designed to help people who have disabilities or chronic care needs, including dementia. Services may be provided in the person's home, in the community, in assisted living facilities, or in nursing homes."[1] These services are excruciatingly expensive. Seventy percent of people will need long-term care during their lifetime, and the average amount of time for which some type of long-term care will be needed is three years.[2]

Facing these staggering expenses, and with either no or inadequate long-term care insurance, most people will choose to apply for MaineCare (Maine Medicaid) long-term care benefits, which are administered by Maine's Department of Health and Human Services (DHHS). While the MaineCare rules allow some strategies to preserve assets in a health crisis, a person often can preserve more assets by doing advance planning. Also, it is preferable to do this planning when the family is not in crisis.

Planning strategies often involve transferring assets outside of the client's ownership and control so that they are not counted as an asset for MaineCare eligibility purposes, and, in the case of a single individual or married couple where both spouses become ill, subject to estate recovery after death. Federal law requires that states seek reimbursement from the estates of people who are fifty-five years of age or older and have received medical assistance through Medicaid. Certain assets, such as a personal residence, that are exempt assets for eligibility purposes are still exposed to estate recovery unless the estate is very small or particular exceptions apply.

## What Is an Asset Protection Trust?

An asset protection trust is one strategy to consider when planning for long-term care expenses. This type of trust is specifically designed for MaineCare long-term care benefits eligibility. The person or couple who establish the trust are called the "settlor" or "settlors."

Distilling an asset protection trust down to its six most basic characteristics, it is:

1. An irrevocable trust where
2. The settlor retains no control, and
3. The settlor may not be a beneficiary, which
4. Prevents trust property from being counted as an asset when applying for MaineCare long-term care benefits, and
5. Protects property from future estate recovery claims by DHHS for the amount of long-term care benefits paid,
6. While retaining certain protections for the settlor.

Holding assets within an asset protection trust is typically recommended over outright gifting of assets for a number of reasons. This is because the trust:

- Provides structure for how assets should be managed during the settlor's lifetime in case trust assets need to be accessed;
- Outlines what will happen to the trust property after the settlor's death to ensure that the settlor's wishes are followed;
- Allows the settlor to change his or her mind about the final disposition of trust assets even though the trust is otherwise irrevocable;
- Promotes transparency and family harmony;
- Preserves the step-up in tax basis on assets that have appreciated in value to minimize or eliminate the amount of capital gains tax paid when the property is later sold;
- Preserves the capital gains tax exclusion in case the personal residence is sold during the settlor's lifetime;
- Provides creditor protection from family members' liabilities or life changes;
- Prevents the trust property from being a countable asset for any income- or asset-based benefits that family members receive; and
- Through a life lease, preserves the settlor's right to remain in the home, and clarifies expectations for the payment of property expenses to prevent DHHS from later penalizing the settlor making payments to maintain property that is no longer owned by the settlor.

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## Roles Within the Trust

In addition to the settlor, who establishes the trust, there are five "roles" within an asset protection trust. To prevent DHHS from considering the trust property as a countable asset if a long-term care benefits application is ever filed, the settlor may not serve in any of these roles.

*Trustee.* The trustee is responsible for managing and administering trust assets. This includes maintaining records of income and expenses and making any tax filings. The trustee also has discretion about when assets will be distributed from the trust to the lifetime beneficiaries.

*Lifetime Beneficiaries.* During the settlor's lifetime, the trustee may only make distributions to the people named as lifetime beneficiaries. Once any assets are distributed to a lifetime beneficiary, the assets belong to him or her. But that lifetime beneficiary can choose to gift those assets back to the settlor, which is one of the "safety valves" of the trust.

*Remainder Beneficiaries.* The remainder beneficiaries are the individuals or entities (for example, charities) who will receive assets remaining in the trust after the settlor's death. This group may be somewhat different from the lifetime beneficiaries.

*Trust Advisor.* The trust advisor has the ability to amend the trust to comply with tax law changes, change the situs (location) of the trust if the settlor relocates to another state, and resolve disputes among beneficiaries. The trust advisor can be a professional with whom the settlor has a long-standing relationship or another family member who does not have a beneficial interest in the trust. Another name for this role is trust protector.

*Trust Advisor Designator.* When drafting an asset protection trust, we do not know when, if ever, a trust advisor will be needed or what task will need to be performed. Therefore, we name a trust advisor designator who may name a trust advisor if one is ever needed. The trust advisor designator must also be someone who does not have an interest in the trust. The drafting attorney, or the then-acting managing partner of our firm, may be named.

## Is an Asset Protection Trust a Good Fit?

The best way to determine whether an asset protection trust is appropriate for you is to meet with an attorney who can evaluate your particular circumstances. There are, however, some primary factors to consider in evaluating whether an asset protection trust may be a good fit.

When a person applies for MaineCare long-term care benefits, the DHHS case worker reviewing the application performs a look-back over the past five years' of financial transactions, including tax returns, closing statements, and account statements of any financial accounts. Transfers of assets made within that time for less than fair market value that do not fit within an exemption will be penalized, and the person will have to pay privately for benefits for a period of time. Therefore, to make a significant financial change like placing assets into an asset protection trust, you must be generally healthy or have robust long-term care insurance coverage to be as confident as possible that you will not need to apply for MaineCare long-term care benefits before the look-back period is past.

At least three highly-trusted, responsible, and available friends or family members are generally needed for the different roles within the trust: the initial trustee and an alternate trustee, both of whom will serve as lifetime beneficiaries, and a third lifetime beneficiary. You must feel comfortable giving up ownership and retaining only minor forms of control over the trust property. To hand over control, you must have complete confidence that the people named in the trust will carry out their assigned roles as instructed. On the other hand, you may prefer to retain direct ownership and control, even if you may not be able to preserve as many assets if a health crisis occurs.

Finally, you must have assets that are appropriate to transfer into the asset protection trust. Often, these trusts are funded primarily with real estate. This is because even real estate that is an exempt asset during lifetime is generally exposed to estate recovery after death. If the real estate is mortgaged, the mortgage would need to be paid off or we would need to obtain consent from the lender prior to a transfer into the trust.

You would not want to fund the trust with retirement assets or any other liquid assets which would have significant tax consequences if transferred or cashed out. If you have other types of liquid assets, then you might decide to transfer a portion of them into the trust, depending on your goals and overall financial picture. But it is important to leave a significant amount in your name individually to maintain independence and in case a health issue arises before the five-year look-back period has passed.

## Conclusion

Despite some of the complicated details that must be worked out when considering and drafting an asset protection trust, this type of trust can provide enormous value for the right person. The trust ensures that a significant portion of your assets are protected against any future long-term care expenses. At the same time, even though you give up ownership and control over property placed into the trust, the trust protects the key tax benefits associated with ownership, preserve the right to continue to use the property, and maintain the right to change your mind about what happens to trust property after death. By planning for the future with an asset protection trust, you can create peace of mind for yourself and transparency about financial planning for your family.

[1] Definitions, Family Caregiver Alliance, https://caregiver.org/definitions-0 (last updated Jan. 31, 2014).

[2] How Much Care Will You Need?, U.S. Dep't of Health and Human Servs., http://longtermcare.gov/the-basics/how-much-care-will-you-need.html (last visited June 27, 2017).

*This article is intended to provide information of a general nature only. It does not provide or replace professional legal advice, and it does not establish an attorney-client relationship with the Maine Elder Law Firm or Rudman Winchell. Please consult an attorney for advice regarding your specific circumstances.*