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LONG-TERM CARE AND RELATED ELDER LAW ISSUES

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I. Introduction.

As John Lennon proclaimed many years ago, "Nobody told me there'd be days like these." Dealing with the issues related to aging are virtually inescapable. Either a person will deal with their own aging, and the interesting challenges that come along with that, or they will have to assist another with their aging. It is important for tax and legal professionals to have background knowledge of these areas so they can properly assist their clients. This outline discusses many of the tax and non-tax issues related to long term care planning.

II. Basic Medicaid Planning.

A. Income and Asset Limits and Allowances.

The Medicaid laws in South Carolina provide specific income and resource requirements that must be met to obtain eligibility for Medicaid for long term care. The current income and asset limits for South Carolina are as follows:

Income Cap Amount	$ 2,382.00
Individual Resource Allowance	$ 2,000.00
Community Spouse Resource Allowance	$ 66,480.00
Monthly Maintenance Needs Allowance (spousal allowance)	$ 3,259.50
Monthly Personal Needs Allowance	$ 30.00
Monthly Penalty Divisor	$ 8,104.52
Life Insurance Limit (face amount)	$ 10,000.00

Pre-paid Funeral Expenses (no limit if irrevocable)	
Aged, Blind or Disabled Resources:	
- income less than $1,074 for individual	$ 7,970.00
- income less than $1,452 for couple	$ 11,960.00
VA Payment if Medicaid Eligible	$ 90.00
IRA/401k (exempt if in payout status)	

B. Income Trust (Miller Trust).

South Carolina is an income cap state, which means that our Medicaid laws place a cap on the income that a person can receive and still qualify for Medicaid for long term care. However, this provision is a little misleading because our State allows a person to use an income trust (Miller Trust) to administer the person's income if it is over the limit, so that the person will qualify for benefits. The result of this analysis is that if the person is over the limit, then they simply need to get an income trust form (which the local Medicaid office provides at no charge) and fill it out. All the income of the person would then have to be applied to their long term care before Medicaid would pay benefits. It is important to distinguish this type of income trust from the income only trust discussed in more detail below.

C. Pre-Planning vs. Crisis Planning.

Pre-planning involves a case where the family does not currently need Medicaid benefits for long term care but realize that it could become necessary in the future. These clients are generally proactive in nature and want to avoid having a long term illness cause them to spend all of their assets before becoming eligible for Medicaid. They have usually seen a friend or family member go through virtually all of their assets for their care before the person becomes eligible for government benefits to fund the care. Pre-planning is normally done as part of an overall estate plan and would include a basic will or revocable living trust and an irrevocable income only trust.

1. Five Year Look-Back. Current Medicaid laws provide that any transfer for less than adequate consideration (essentially a gift) will be subject to a five year look-back period. If an application is made before five years runs from the date that the gift was made, the applicant will be subject to a penalty, which is calculated by taking the amount of the gift and dividing it by the current penalty divisor. Once the penalty period has run, the applicant would be eligible to receive benefits. There is a very important nuance with regard to the penalty period calculation. If an applicant makes application four years and eleven months after making a gift, they will be subject to the full penalty, even though they could have simply waited a month before applying. For that reason, the applicant should wait until the five year look-back period runs before making application for Medicaid benefits for long-term care.

Crisis planning involves a case where the family needs funds immediately to pay for the care of a family member. A much different approach is required for crisis planning, because the look-back period eliminates many of the options that exist with pre-planing for Medicaid.

D. Basic Medicaid Planning Tools.

Elder law practitioners are called upon to help families deal with the issues related to long term care. Whether it is pre-planning or crisis planning, clients need professional assistance navigating through the area of government benefits for long term care. The following is a list of many of the tools that elder law attorneys use in assisting clients with government benefits.

1. Transfers to Irrevocable Income Only (or no income and no principal) Trust.
   - Five year look-back period.
   - Preserve tax benefits.
   - Grantors can initially serve as trustees.
   - Grantors can retain limited power of appointment.

2. Outright Gifts.
   - Loss of stepped-up tax basis.
   - Loss of sale of residence exclusion under I.R.C. § 121.
   - Loss of principal residence taxation for county property taxes.
   - Possibility of loss of resources if misused by recipient.
   - Subject to creditor claims of recipient.

3. Transfer Home and Retain Life Estate.
   - Stepped-up tax basis is retained under I.R.C. § 2036.
   - Loss of sale of residence exclusion under I.R.C. § 121.
   - Subject to creditor claims of recipient.
   - Remaindermen required to sign for mortgage or sale.

4. Transfer Assets to Revocable Living Trust to Try to Avoid Estate Recovery.
   - Current position of SCDHHS is that residence is not exempt for eligibility purposes if placed in revocable living trust.
   - Assets in revocable living trust remain subject to creditor claims.[1]

5. Prepay for Funeral Services.
   - No limit if prepayment is irrevocable.

6. Purchase or Pay Off Exempt Automobile.

7. Make Exempt Renovations to Residence.
   - Section 6014 of the Deficit Reduction Act allows up to $500,000 in equity, or up $750,000 if raised by the state. South Carolina allows $603,000 in equity.

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[1] S.C. Code Ann. § 62-7-505 (1976, as amended).

8. Pay off Mortgage on Exempt Residence.

9. Take out Reverse Mortgage.

10. Possibly use One (1%) Percent Deed for Residence for Estate Recovery Purposes.
    - Better to draft the deed as tenants in common with rights of survivorship (TICWROS) as opposed to joint tenants with rights of survivorship (JTWROS). While there is no statutory prohibition against using JTWROS when there is unequal ownership, the TICWROS form may work better to accommodate the unequal ownership.

11. Promissory Note for Amount that Community Spouse[2] is Over Community Spouse Resource Allowance.
    - May need the institutional spouse to transfer assets to community spouse.
    - Need to have children on board with plan.
    - Note must be non-negotiable.
    - Note cannot be self-cancelling at death.
    - Must be actuarially sound (payout less than or equal to life expectancy).

12. Medicaid Compliant Annuity for Community Spouse.
    - Must be actuarially sound (payout less than or equal to life expectancy).
    - Required to name state as beneficiary.

III. Special Needs Trusts.

A. Under Age 65.

Long term care is normally associated with individuals who are over the age of sixty-five. However, on occasion individuals under the age of sixty-five need long term care, and below are some of the options available to them.

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[2] For Medicaid purposes, the term "community spouse" generally refers to the healthy spouse that remains in the home and does not need care, while the term "institutional spouse" generally refers to the spouse that needs skilled care.

1. First Party Special Needs Trust.

If an individual is disabled and in need of medical assistance and has too much in resources, he or she (or their parent, grandparent or the court) may establish a trust to transfer the assets into so that the person becomes eligible to receive government benefits for care.[3] This type of trust, which is commonly referred to as a (d)(4)(A) trust, requires that the state Medicaid office be repaid from trust assets after the disabled person dies. Any funds remaining after the state is reimbursed for Medicaid payments may be distributed to designated beneficiaries.

2. Third Party Supplemental Needs Trust.

Family or friends of a disabled person may also establish a trust for the benefit of the disabled person. This type of trust is commonly referred to as a third party supplemental needs trust and is designed to hold and administer assets that did not belong to the disabled person. Since this trust has assets that did not belong to the disabled person, it is not required to repay the state Medicaid office from trust assets after the disabled person dies.

There is a very important distinction between over age sixty-five and under age sixty-five individuals when it comes to gifting. If a person is under age sixty-five and needs Medicaid insurance but has too much in resources, the current Medicaid laws allow the individual to simply gift their assets away and then qualify for Medicaid without being subject to any look-back period. This opens up the option of the disabled person gifting the assets to their family or friends who could then establish a third party supplemental needs trust for the disabled person.

B. Over Age 65. Supplemental Needs Trust Established by Community Spouse.

Elder law planning often requires planning for a family where one of the spouses is disabled or in need some care and the other is healthy and able to care for themself. The attention is initially focused on how to assist the spouse in need, and it is oftentimes taken for granted that the spouse in need of care would be the first spouse to die. However, many times the healthy spouse dies before the other spouse. This possibility should be considered with developing a plan for the couple.

The typical way to plan for this is to transfer the assets from the spouse in need to the healthy spouse and then have the healthy spouse set up a will or living trust that provides that if he or she dies first the assets will be held in a supplemental needs trust for the disabled spouse. The assets in the supplemental needs trust would not be counted against the disabled spouse when and if the disabled spouse applies for Medicaid for long term care.[4]

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[3] 42 U.S.C. § 1396p(d)(4)(A).

[4] North Carolina requires that supplemental needs trusts be testamentary trusts set forth in a will and not in a living trust. South Carolina has not taken that position.

IV. Irrevocable Trust for Pre-Planning.

A. Outright Gift vs. Transfers to Irrevocable Trust.

1. Outright Gift.

To start the five year look-back period clients are faced with the question of whether to gift their assets to their children or place them into an irrevocable trust. Giving the assets to the children has a certain amount of appeal because it is so simple, but once clients understand the potential risks associated with gifting the assets to the children they see the benefit of using an irrevocable trust.

When assets are given to the children, the assets then become subject to the creditor claims of the children, including any claims resulting from the divorce of a child. Also, for appreciated assets, the children receive the assets at the lower cost basis of the parents. In contrast, if the surviving parent were to leave the assets to the children at death, the children would get to step up the tax basis to the fair market value of the assets as of the parent's date of death.[5] Also, if the parents gift the children their residence they forfeit the county principal residence tax rate (including any homestead allowance), along with the principal residence exclusion[6] from capital gains tax.

2. Transfer to Irrevocable Income Only Trust.

Transfers to an irrevocable income only trust preserve many necessary benefits while still starting the five year look-back period. Since irrevocable income only trusts are formed as part of a proactive estate plan, the clients are still competent to serve as trustees of the trust. This retains a lot of control in the clients that would be lost with outright gifts to the children. In addition to the control when serving as trustee, the trust offers many other benefits.

(i) Preservation of Tax Benefits. The trust is a grantor trust for income and estate purposes. The retained right to all the income from the trust causes the trust assets to be included in the grantor's estate.[7] It also causes all income tax to be attributed to the grantor.[8] The terms of the trust specifically allow the grantor to reside in any residence owned by the trust and, if requested by the grantor, to require the trustee to sell the residence and purchase a replacement residence. Therefore, the grantor's principal residence county ad valorem tax rate and homestead exemption are retained. Likewise, since the trust is a grantor trust for income tax purposes, the

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[5] I.R.C. § 1014.

[6] I.R.C. § 121.

[7] I.R.C. § 2036.

[8] I.R.C. § 677.

grantor retains their principal residence exclusion from capital gain tax under Section 121 of the Internal Revenue Code.

(ii) Reservation of Limited Power of Appointment. In the trust the grantor can reserve the right to change the beneficiaries of the trust to any one or more members of a certain class of beneficiaries. The trust is designed so that the grantor cannot access any principal for their benefit. They are only entitled to the income from the trust. If the grantor needs any of the principal, they would have to gift it out of the trust and to the children who could, but who are not required to, use the principal for the grantor. The reason that the reservation of the power of appointment is so helpful is because the grantor can change the beneficiaries if a child or children decide not to help out the parent when assets are transferred to them. For that reason, this provision is sometimes referred to as a hammer clause. This provision also serves to make the trust a grantor trust for estate purposes.[9]

B. Not a Self-Settled Asset Protection Trust.

Many states allow individuals to establish self-settled asset protection trusts. South Carolina is not one of those states.[10] The question may arise as to whether the income only trust is a self-settled asset protection trust. Since the provisions of the trust allow the grantor to receive all the income from the trust, the income is subject to creditor claims of the grantor. However, since the trust provides that the grantor cannot get to any of the principal of the trust, the principal is not subject to creditor claims of the grantor.[11]

C. Use of Trust Protector.

The use of trust protectors is specifically covered by statute in South Carolina.[12] It could be helpful to include a trust protector in the irrevocable income only trust for a few reasons. If something happens to the trustees or beneficiaries named in the trust and no one else is able under the trust provisions to accommodate such unexpected events, then a trust protector could step in and make any necessary changes. It may also be necessary to alter one or more of the grantor trust provisions for tax or government benefit purposes.

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[9] I.R.C. §§ 2036 & 2038.

[10] S.C. Code Ann. § 62-7-505 (1976, as amended).

[11] The exception to this position would be the application of a fraudulent conveyance statute. However, in the context of elder law planning, a fraudulent conveyance statute would rarely, if ever, come into play.

[12] S.C. Code Ann. § 62-7-818 (1976, as amended).

D. EIN and Tax Reporting.

Since the irrevocable income only trust is designed to be taxed as a grantor trust, the deemed owner of the trust must include the activity of the trust on his or her personal tax return.[13] Most financial institutions require that the trust have its own tax identification number even though all income will be taxed to the grantor as if the assets were owned by the grantor individually.

When a grantor trust has a tax identification number separate from the deemed owners's social security number, it is important to notify the Internal Revenue Service where the income from the trust will be reported. This is done by filing an informational 1041 return that includes only the trust's name, address, and tax identification number.[14] The government encourages filers to provide limited income information on an attachment to the 1041 return. The information on the attachment should be limited to basic information so as not to create any confusion between the 1041 return for the trust and the 1040 return for the deemed owner.

It is important to know how the payor (such as a stock brokerage company, corporation or partnership) of the income for trust assets will be reporting the income. If the income is reported using the trust name and trust tax identification number, then a 1041 return needs to be filed.

On the other hand, if the payor has the assets set up under the deemed owner's social security number and name, then income from the assets can be reported only on the deemed owner's 1040 return without the need to file a 1041 return. In that case, Treasury Regulation § 1.671-4(b)(2)(i)(A) allows the payor to issue any related 1099s and/or Schedules K-1 directly to the deemed owner. With this option it is important to maintain for titling purposes that the assets are technically owned by the trust and not the deemed owner. Otherwise, this option could inadvertently create problems with the deemed owner's overall estate or Medicaid plan.

E. Eligibility Requirements for VA Aid and Attendance.

To qualify for VA Aid and Attendance, a veteran or his or her spouse must have been in the military for at least one day during a designated war time[15] and in active military service for at least ninety days. The person must also need long term care type benefits for customary activities of daily living, such as bathing, toileting, dressing, eating, and transferring/mobility. The resource limit for 2021 for Aid and Attendance is $130,773. This amount includes income for the year, which means, for example, that if an applicant has 30,000 in annual income, then they can only have

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[13] Treas. Reg. § 1.671-2(a).

[14] Treas. Reg. § 1.671-4(a).

[15] The wartime dates can be found at www.benefits.va.gov/pension/wartimeperiod.asp.

100,773 in non-exempt assets.[16] To the extent that a person's allowable expenses exceed their income, the following benefits could be received:

-	For a veteran without any dependents	$1,936 per month.
-	For a married veteran	$2,295 per month.
-	For a surviving spouse of veteran	$1,244 per month.

As of October 18, 2018, there is a three (3) year look-back for gifts made by the applicant or their spouse. If an applicant has made gifts and then applies before the look-back period has expired, the VA will withhold benefits for the duration of a penalty period, which is calculated by taking the amount gifted and dividing it by the penalty divisor. For 2021, the penalty divisor is 2,295. For example, if an applicant or their spouse gifted $22,950 to their children and then made application for benefits before the three year look-back period pertaining to such gifts had expired, the applicant would be penalized (and have to wait a period of) 10 months (22,950/2,295 = 10) before being eligible to receive Aid and Attendance benefits.

The VA has improved its turn around time for applications for Aid and Attendance over the past few years. Once a completed application[17] is sent to the VA, the turn around time is somewhere around four to six months. Just a few years ago, before the VA came under its recent media and political scrutiny, applications would take eight to twelve months to move through the system.

F. Irrevocable Trust for VA Benefits.

1. No Income or Principal to Grantor.

When an irrevocable trust is used for VA aid and attendance planning, it is important to consider using a trust that provides no income or principal to the grantor. The VA may count the principal assets that generate the income paid to the grantor, even if such assets are placed in an irrevocable trust and the trust specifically provides that the grantor cannot access the principal. The same gifting (or transfer) penalty rules mentioned above that apply to outright gifts to children also apply to transfers to an irrevocable trust.

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[16] Exempt assets would include a residence (and up to 2 acres), vehicle, and personal and household effects.

[17] A completed application would include all the necessary service, asset and health related information and documents needed to get approved for benefits. Some applications are sent in early and then supplemented with additional information later. The VA normally turns around completed applications faster than ones that need to be supplemented.

2. Tax Reporting.

When a trust that does not allow any income or principal to the grantor (often referred to as a "no income and no principal trust") is used, a 1041 return must be filed. Any income distributed out to the lifetime beneficiaries of the trust would have to be picked up as income on the beneficiaries' personal returns. The trust's 1041 return would show a deduction for the amounts that were distributed to the lifetime beneficiaries. Any income retained in the trust would generate a tax based on the trust's income tax rates.

3. Limited Power of Appointment.

As mentioned above, irrevocable trusts used in the elder law context often include limited powers of appointment which can be used by the grantor to redirect assets upon their death to members of a class defined in the trust (often the grantor's children and other lineal descendants). If the trust is designed to provide no income or principal to the grantor, it is important to make sure that the limited power of appointment can only be exercised by the grantor in their last will and testament. Otherwise, if the limited power of attorney can be exercised in a written statement attested to during life, the trust may be deemed a grantor trust for income tax purposes, causing the income to be reported on the grantor's individual 1040.[18] This could be detrimental if the person is seeking VA Aid and Attendance benefits, since the VA traces income back to its source through the IRS and counts the source of the income as an asset of the grantor. The agency that administers Medicaid, the South Carolina Department of Health and Human Services, does not trace income for applications for Medicaid.

V. Other Long-Term Care Options.

There are a number of options for long term care other than seeking Medicaid or VA benefits to fund long-term care, which include the following:

A. Self-funded Care. This works great if the person has the resources available to pay for the care. However, it could cause the children of a person to have conflicting emotions about using their parent's assets to pay for the parent's care if it means that the children would receive less when the parent passes away. The parents may also not like the idea of reducing the financial legacy that they intend to leave to their children.

B. Long Term Care Insurance. This is the best of all the ideas. If a person has long-term care insurance, they will have more options for their care. Also, the person and their family will not be concerned about depleting the person's assets and reducing the financial legacy that they want to leave to their children.

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[18] I.R.C. § 674(a).

C. Living with a Child. While this sounds like a good idea in the beginning, this will often end up being detrimental to the family. The level of care that the parent receives is normally not the same that a trained person would provide. Deep resentment could, and oftentimes does, result between the parent and the child providing the care and also between the child providing the care and their sibling(s). This could also create a great deal of stress between the care giver child and their spouse and children.

D. Hospice Care. Over the past several years, the use of hospice care, which Medicare normally pays for, has expanded to help with some of the long term care of loved ones prior to their death. While the expansion of hospice care has helped some, it is still considered a temporary solution.

VI. Advance Medical Directives and Powers of Attorney.

It is important to put the proper powers of attorney in place for financial and health care matters so that the family can assist the person with their assets and care as the person's health declines. The health care power of attorney provides a mechanism for individuals to allow for someone to consent to organ donation on their behalf and to take them off life support in the case of a terminal illness. A do not resuscitate order (commonly known as a DNR) is different from a health care power of attorney and is typically provided by the hospital.

VII. Conclusion.

Dealing with and planning for end of life issues is probably not on a person's list of favorite things to do. However, not planning can oftentimes be even less enjoyable. There are many ways to plan in advance for the issues that will arise for an aging person. It is important for a person to be involved in the planning for their long term care before they need it, so they can approach it with competent foresight. Doing so makes it easier for the person and for their family when the time comes for the person to receive the care. Having a person in a comfortable place to enjoy the final days of their life is important and should be dealt with appropriately. It is also important for the family to understand the tax implications of the various long-term care planning options.