Legal Matters®

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Using trusts in Medicaid planning

With careful planning, you may be able to preserve some of your estate for your children or other heirs while meeting Medicaid's low asset limit.

The problem with transferring assets is that you have given them away. You no longer control them, and even a trusted child or other relative may lose them. A safer approach is to put them in an irrevocable trust. A trust is a legal entity under which one person — the "trustee" — holds legal title to property for the benefit of others — the "beneficiaries." The trustee must follow the rules provided in the trust instrument. Whether trust assets are counted against Medicaid's resource limits depends on the terms of the trust and who created it.

A "revocable" trust is one that may be changed or rescinded by the person who created it. Medicaid considers the principal of such trusts (that is, the funds that make up the trust) to be assets that are countable in determining Medicaid eligibility. Thus, revocable trusts are of no use in Medicaid planning.

Income-only trusts

An "irrevocable" trust is one that cannot be changed after it has been created. In most cases, this type of trust is drafted so that the income is payable to you (the person establishing the trust, called the "grantor") for life, and the principal cannot be applied to benefit you or your spouse. At your death the principal is paid to your heirs. This way, the funds in the trust are protected and you can use the income for your living expenses.

For Medicaid purposes, the principal in such trusts is not counted as a resource, provided the trustee cannot pay it to you or your spouse for either of your benefit. However, if you do move to a nursing home, the trust income will have to go to the nursing home.

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You should be aware of the drawbacks to such an arrangement. It is very rigid, so you cannot gain access to the trust funds even if you need them for some other purpose. For this reason, you should always leave an ample cushion of ready funds outside the trust.

You may also choose to place property in a trust from which even payments of income to you or your spouse cannot be made. Instead, the trust may be set up for the benefit of your children, or others.

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CORREIRA LAW
800-699-5040 | CorreiraLaw.com

20 Park Plaza, Boston, MA, 617.723.5040
20 Cabot Boulevard, Mansfield, MA, 508.991.5040
1010 GAR Highway, Swansea, MA, 508.679.5040
1415 Panther Lane, Naples, FL, 239.649.5040
10 Dorrance Street, Providence, RI, 401.454.5040

The dangers of using an online power of attorney form

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A recent Pennsylvania case involving a power of attorney demonstrates the problem with using online estate planning forms instead of hiring an attorney who can make sure your documents are tailored to your needs.

Mercedes Goosley owned a home in Pennsylvania. In 2013, she named one of her six children, Joseph, as her agent under a power of attorney using a boilerplate form that Joseph downloaded from the internet. Unbeknownst to Joseph, the power of attorney required Mercedes to be declared incompetent for Joseph to act as her agent.

Powers of attorney can be either "immediate" or "springing." An immediate power of attorney takes effect as soon as it is signed, while a springing power of attorney only takes effect when the principal becomes incapacitated. The problem is that springing powers of attorney create a hurdle in order for the agent to use the document. When presented with a springing power of attorney, a financial institution will require proof that the incapacity has occurred, often in the form of a letter from a doctor.

In this case, Joseph began acting for Mercedes

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These beneficiaries may, at their discretion, use the property for your benefit if necessary. However, there is no legal requirement that they do so.

One advantage of these trusts is that if they contain property that has increased in value, such as real estate or stock, you (the grantor) can retain a "special testamentary power of appointment" so that the beneficiaries receive the property with a step-up in basis at your death. This will also prevent the need to file a gift tax return upon the funding of the trust.

Remember, funding an irrevocable trust within the five years prior to applying for Medicaid (the "look-back period") may result in a period of ineligibility. The actual period of ineligibility depends on the amount transferred to the trust.

Testamentary trusts

Testamentary trusts are trusts created under a will. The Medicaid rules provide a special "safe harbor" for testamentary trusts created by a deceased spouse for the benefit of a surviving spouse. The assets of these trusts are treated as available to the Medicaid applicant only to the extent that the trustee has an obligation to pay for the applicant's support. If payments are solely at the trustee's discretion, they are considered unavailable.

Therefore, these testamentary trusts can provide an important mechanism for spouses to leave funds for a surviving institutionalized husband or wife that can be used to pay for services that are not covered by Medicaid. These may include extra therapy, special equipment, evaluation by medical specialists or others, legal fees, visits by family members, or transfers to another nursing home if that became necessary.

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Special needs trusts

The Medicaid rules also have certain exceptions for transfers for the sole benefit of disabled people under age 65. Even after moving to a nursing home, if you have a child or other relative who is under age 65 and disabled, you can transfer assets into a trust for his or her benefit without incurring any period of ineligibility. If these trusts — also called "supplemental needs trusts" — are properly structured, the funds in them will not be considered to belong to the beneficiary in determining his or her own Medicaid eligibility.

To find out whether a trust is the right Medicaid planning strategy for you, talk to your attorney.

Social Security benefits for spouses and ex-spouses

A little-known feature of the Social Security system is that in addition to paying benefits for a retired worker, it may provide benefits to the worker's spouse, an ex-spouse if the marriage lasted at least 10 years, and dependent children and grandchildren, depending on the circumstances. Here is a general description of the benefits for spouses and ex-spouses.

Your spouse is entitled to an amount equal to one-half of your full primary insurance amount (PIA). In order to receive this benefit, your spouse must be at least 62 years of age or caring for your child, who is entitled to receive benefits and is either younger than 16 or disabled.

It may be that your spouse could receive more from Social Security based on his or her own earnings record than through your spousal benefit. If this is the case, the Social Security Administration (SSA) automatically provides your spouse with the larger benefit.

If you retire early, your spouse will still receive benefits based on one-half of the PIA you would have received had you waited until full retirement age to retire. But in order to receive a full half of your PIA, your spouse must wait to begin receiving the retirement benefits at her full retirement age. If she opts to receive benefits before that time, she will be penalized according to a formula similar to that used to compute the reduced benefits of workers who retire early.

Benefits for a divorced spouse

If you are the retired worker, your divorced spouse is eligible to receive an amount equal to one-half of your PIA, provided the marriage lasted at least 10 years. The rules are similar to those for spousal benefits described above, except that your divorced spouse can begin receiving benefits even before you have begun receiving benefits yourself.

Divorced spouses who had more than one marriage that lasted at least 10 years do not receive multiple benefit checks, one for each marriage. But the SSA does automatically choose the former marriage that will yield the largest benefit to the ex-spouse.

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Survivor's benefits

If you die and your spouse has by that time reached full retirement age, your spouse begins receiving your actual benefits. This is true even if you and your spouse have divorced, so long as you had been married for at least 10 years. If your surviving spouse has not yet reached full retirement age but is at least age 60, he or she receives an actuarially reduced percentage of your benefits. At age 60, for example, she will receive 71.5 percent of your actual benefits. This percentage increases each year until she reaches full retirement age herself, at which point she begins receiving 100 percent of your actual benefits. Spouses younger than 60 may be able to receive benefits in limited circumstances, such as cases of disability or if they are caring for a disabled child.

Finally, widows and widowers (if not divorced) of a deceased worker or his or her children under age 18 are entitled to a lump sum death benefit.

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without getting a declaration of her incompetency. After she moved into a nursing home, Joseph listed her home for sale and accepted a purchase offer as agent for his mother under the power of attorney. At the time, Joseph's brother, William, was living in the home, and Joseph instructed William to move out. This resulted in a dispute that ended up in court, with William arguing that Joseph did not have authority to act as his mother's agent.

A Pennsylvania appeals court eventually determined that Mercedes had intended to execute an immediate power of attorney as evidenced by the fact that Joseph had acted as Mercedes' agent since 2013 and routinely conducted affairs on her behalf without Mercedes restricting or objecting to his agency.

While the court ultimately ruled in Joseph's favor, Joseph and Mercedes could have saved time and money by consulting with an attorney before signing the power of attorney. An attorney would have been able to explain the difference between immediate and springing documents and tailor the power of attorney to Mercedes' needs. Talk with your attorney before creating any estate planning documents.

CORREIRA LAW
20 Park Plaza, 4th Floor
Boston, MA 02116

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How you can end up in Medicare's 'doughnut hole'

Medicare prescription drug (Part D) plans can have a coverage gap — called the "doughnut hole"— which limits how much Medicare will pay for your drugs until you pay a certain amount out of pocket. Although the gap has gotten much smaller since Medicare Part D was introduced in 2006, there still may be a difference in what you pay during your initial coverage compared to what you might pay while caught in the coverage gap.

When you first sign up for a Medicare prescription drug plan, you will have to pay a deductible, which can't be more than $445 (in 2021). Once you've paid the deductible, you still need to cover your co-insurance (also called co-payment) amount (depending on your drug plan), but Medicare will pay the rest.

Once you and your plan pay a total of $4,130 (in 2021) in a year, you enter the coverage gap. Previously coverage stopped completely at this point until total out-of-pocket spending reached a certain amount. However, the Affordable Care Act mostly eliminated the doughnut hole. In 2021, until your total out-of-pocket spending reaches $6,550, you'll pay 25 percent for brand-name and generic drugs. Once total spending for your covered drugs exceeds $6,550 (the "catastrophic coverage" threshold for 2021), you are out of the coverage gap and you will pay only a small co-insurance amount.

Once you are in the coverage gap, your yearly deductible and co-insurance payments count toward the amount you need to pay to reach catastrophic coverage. The amount of out-of-pocket costs that you have to pay to reach catastrophic coverage will vary, depending on the type of drugs you take. In the case of brand name drugs, you will pay only a certain percentage of the price, but the entire price will count toward the amount you need to qualify for catastrophic coverage. With generic drugs, only the amount you pay will count toward getting you out of the doughnut hole.

Bear in mind that only payments for drugs that are covered by your plan count towards the out-of-pocket threshold. Your premium and the portion of the drug cost that Medicare pays do not count toward reaching catastrophic coverage, either.