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15th Annual Cushing & Dolan Spring Tax and Estate Planning Seminar
"Times, They are A-Changing."

Tuesday, May 2, 2017

8:00 am – 8:05 am	Welcome
8:05 am – 8:55 am	PART I: Recent Trust & Estate Tax Developments - a Hodgepodge of Developments You Need to Know! by Leo J. Cushing, Esq., CPA, LLM
8:55 am – 9:25 am	PART II: Trump Part 1 by Luke C. Bean, Esq., LL.M.
9:25 am – 9:35 am	Break
9:35 am – 9:55 am	PART II: Planning in an Uncertain Development by Luke C. Bean, Esq., LL.M.
9:55 am – 10:45 am	PART III: Medicaid Planning Update - How to Design the Perfect Income Only Irrevocable Trust! by Todd E. Lutsky, Esq., LLM

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375 Totten Pond Road, Suite 200
Waltham, MA 02451

Kimberly Papulis

From: Leo J. Cushing, Esq., CPA, LLM <leo@cushingdolan.ccsend.com> on behalf of Leo J. Cushing, Esq., CPA, LLM <lcushing@cushingdolan.com>
Sent: Thursday, April 13, 2017 10:02 AM
To: Leo Cushing
Subject: Don't miss the 15th Annual Cushing & Dolan Spring Tax and Estate Planning Seminar!

Cushing & Dolan, P.C. 2017 Spring Seminar
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Spring has arrived and so has the Cushing & Dolan, P.C. 15th Annual Spring Seminar entitled "Times, They are A-Changing."

PART I:

Recent Trust & Estate Tax Developments - a Hodgepodge of Developments You Need to Know!
by Leo J. Cushing, Esq., CPA, LLM

- Are irrevocable trusts really irrevocable?

- The asset protection benefits of decanting assets to a new trust , Morse v. Kraft, *466 Mass. 92 (2013)* & Ferri v. Powell-Ferri, *476 Mass. 651 (2017)* cases - How late is too late to act to decant?
- Nonjudicial settlements can be used to modify irrevocable trusts without adverse estate tax consequences

- The Supreme Judicial Court provides guidelines in Pfannenstiehl v. Pfannenstiehl *475 Mass. 105 (2016)* on how to design third party spendthrift trusts to protect assets.

- Should you be considering a self-settled New Hampshire or other Domestic Asset Protection Trust?

- Act now! Discount planning may be a thing of the past. Where are we with the Proposed Regulations under IRC § 2704?

- The quandary of dealing with digital assets. The Supreme Judicial Court is about to rule.

- Is a life estate a property interest or an interest in trust for Medicaid eligibility purposes? The Supreme Judicial Court is about to rule.

- A how-to guide to change domicile to Florida to save income and estate taxes.

- Recent fiduciary liability cases

  - Should you serve as trustee?
  - Should you obtain errors and omissions insurance as a condition to serving as trustee?
  - Are you keeping the beneficiaries informed?
  - How fast can you run?

PART II:

Estate Tax Techniques in an Estate Tax Repeal Environment
by Luke C. Bean, Esq., LL.M.

- A short history of the Estate, Gift and GST system - Now you see it now you don't!

- Current proposals

- Repeal estate, gift and GST Tax
- Repeal estate and GST tax and keep gift tax as backstop to income tax
- Repeal estate tax but keep GST tax and gift tax

- Using general powers of appointment to take advantage of possible estate tax repeal in the event one spouse dies while the estate tax has been repealed.

- Using multi-generational trusts to protect assets in the event of an estate tax repeal.

- Using Grantor Trusts in an Estate Tax Repeal Environment.

PART III:

Medicaid Planning Update - How to Design the Perfect Income Only Irrevocable Trust!
by Todd E. Lutsky, Esq., LLM

- In this part, Attorney Todd Lutsky will take you through how to design the perfect income only irrevocable trust based upon his recently published article "Designing the Perfect Income-Only Irrevocable Trust" *Estate Planning Journal, Jan 2017 Estate Planning Journal (WG&L)*

  - Obtaining step-up in basis on death
  - Preserving Grantor Trust status
  - Who can serve as Trustee?
  - A life estate or no life estate - That is the question?
  - Retained powers to control final disposition

- Attorney Lutsky also will review recent developments in the area of Medicaid planning and proposed regulations that would dramatically change basic long term care planning concepts.

DATE:
Tuesday, May 2, 2017

TIME:
Registration & Networking: 7:00AM - 8:00AM
Presentation: 8:00AM - 11:00AM
Questions & Answers

LOCATION:
Embassy Suites by Hilton
550 Winter Street
Waltham MA 02451

SPEAKERS:
Leo J. Cushing, Esq., CPA, LLM
Todd E. Lutsky, Esq., LL.M.
Luke C. Bean, Esq., LL.M.

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Attorney Leo J. Cushing is the founding Partner of Cushing & Dolan, P.C. Established in 1984, the firm has provided comprehensive Estate and Business Planning with a focus on Taxation to many families and businesses throughout the Commonwealth of Massachusetts and New England. Leo is the co-editor of the standing volume of MCLE's "Preparing Fiduciary Income, Gift, and Estate Tax Returns" and currently is in his sixth year of teaching "Income Taxation of Decedent's Estate & Trusts and Post-Mortem Planning" at Boston University School of Law. In addition to being an attorney, Leo is also a CPA (an alumnus of Ernst & Whinney) and holds an LLM in Taxation from Boston University School of Law.

Attorney Todd E. Lutsky manages the Elder Law group at Cushing & Dolan, P.C. and has successfully litigated numerous challenges to the award of benefits to Massachusetts citizens. Todd has an LLM in Taxation from Boston University School of Law and writes extensively on the topic of Elder Law and Asset Protection. Todd also teaches Elder Law in the Graduate Tax Program at Boston University School of Law.

Attorney Luke C. Bean manages the Tax group at Cushing & Dolan, P.C. This includes responsibility for the preparation of Estate and Gift Tax returns and Trust Administration of all kinds as well as sophisticated Estate Planning for business owners and wealthy clients. Luke graduated from The Pennsylvania State University with a degree in Economics, and is a graduate of Boston College Law School, Magna Cum Laude. He also earned an LL.M. in Taxation at Boston University School of Law.

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MEET SOME OF OUR STAFF

LEO J. CUSHING, ESQ., CPA, LLM

Leo is the founding partner of Cushing & Dolan, P.C., which was established in 1984, and has over 25 years of experience representing business owners on formations, operations, tax planning, mergers and acquisitions, venture capital funding techniques, asset protection and shareholder estate, gift and income tax planning. Leo previously prosecuted criminal tax cases as an Assistant Attorney General for the Commonwealth of Massachusetts and was a Tax Attorney with the international accounting firm of Ernst & Young (formerly Ernst & Whinny).

PAMELA R. TANKLE, ESQ., LLM

Pamela R. Tankle is an Associate in Cushing & Dolan's Corporate Department. Her practice focuses on corporate law and tax law. She is experienced in the areas of business entity formation, corporate compliance, shareholder agreements, business reorganizations, asset protection, business succession planning, income tax planning and the preparation of individual and corporate income tax returns.

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These services are provided on an exclusive basis to our firm's clients through Attorney John P. McGonagle. John is a licensed Patent attorney with over 20 years of experience. John can be reached at 800 Hingham Street, Suite 2N, Rockland, MA 02370 - Tel No. 781-871-4000; Fax 781-871-6886.

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Leo J. Cushing is the founding Partner of Cushing & Dolan, P.C., a Boston based law firm established in 1984 specializing in closely held businesses, taxation, sophisticated estate planning, elder law and real estate. Leo's practice includes all aspects of sophisticated estate planning techniques, asset protection, trust planning, charitable giving and resolution of tax controversies. Prior to establishing Cushing & Dolan, P.C., Leo earned his certified public accountant designation while working as a tax professional for the international accounting firm of Ernst & Young. Prior to Ernst & Young, Leo served as an Assistant Attorney General for the Commonwealth of Massachusetts where he prosecuted criminal tax cases and defended the Commonwealth of Massachusetts in various civil claims against state agencies.

Leo is a former Director of the Boston Estate Planning Council. He is a member of The Boston Bar Association, The Massachusetts Bar Association, The National Academy of Elder Law Attorneys, The American Institute of CPAs, The American Academy of Attorney-CPAs, The Boston Tax Council and The Boston Probate and Estate Planning Forum. He is a Co-Chair of The Estate Planning, Trusts & Estate Administration Committee for The Real Estate Bar Association for Massachusetts. He is also on the Board of Directors for The Real Estate Bar Association for Massachusetts. In 2010, Leo was appointed to The Notre Dame Law School Advisory Council. In 2010, Leo was also appointed a Lecturer in Law at Boston University School of Law's Graduate Tax Program.

Leo has written and lectured extensively on all aspects of taxation and estate planning. Leo is a much sought after speaker as he is able to articulate complex issues in a way that is clear, concise and easy to understand. Recently, Leo has been a speaker for The Boston Estate Planning Council, The Massachusetts Bar Association, The Real Estate Bar Association for Massachusetts, The Massachusetts Association of Accountants, The Massachusetts Society of CPAs, The American

Institute of CPAs, The National Business Institute, The Foundation For Continuing Education, Avidia Bank and The Community Foundation of North Central Massachusetts and the Montachusett Estate and Retirement Planning Council. Leo is a graduate of Boston Latin School, and he earned his Bachelors of Science in Accounting at the University of Notre Dame. He also earned his J.D., cum laude, from the New England School of Law, and his Master of Laws in Taxation from the Boston University School of Law. Leo is also a Certified Public Accountant.

Leo is married with two children and currently lives in Lexington, Massachusetts.

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2017 Spring Seminar

Tuesday, May 2, 2017

PART I:

Recent Trust & Estate Tax Developments - a Hodgepodge of Developments You Need to Know!

Presented by:

Leo J. Cushing, Esq., CPA, LLM
lcushing@cushingdolan.com

I. The Supreme Judicial Court Provides Guidelines in ***Pfannenstiehl v. Pfannenstiehl***, 475 Mass. 105 (216) on how to design third party spendthrift trusts to protect assets.

(a) Overview:

1. In the context of a divorce, should the present value of the husband's beneficial interest in a discretionary spendthrift trust ("The 2004 Trust") be included in the parties divisible marital assets pursuant to M.G.L. c.208, §34?

2. As part of the judgment of divorce in 2012, Judge Angela M. Ordonez, the Chief Judge of the Probate Courts, awarded Diane L. Pfannenstiehl 60% of her husband Curt F. Pfannenstiehl's interest in the present value of The 2004 Trust.

3. At that time, the judge valued Curt's interest at $2,265,474.34 after the judge determined that the total value of The 2004 Trust was $24,920,217.37.

4. The judge determined that Curt had a 1/11th interest in the trust and therefore divided $24,920,217.37 by 11 to determine $2,265,474.

The judge then ordered that the trustee pay over to the wife the sum of $1,333,047 or about 60% of his interest.

5. The Appeals Court affirmed the Probate Court but the Supreme Judicial Court reversed finding that "Curt's interest in The 2004 Trust is so speculative as to constitute nothing more than an expectancy and thus that it is not assignable to the marital estate.

6. In reversing the decision, the court noted that Curt's expectancy of future acquisition of income from The 2004 Trust is not part of the marital estate but on remand the judge, pursuant to G.L. c.208, §34, may consider that expectancy as part of the "opportunity of each spouse for a future acquisition of capital assets and income" and, in the judge's determination therefore, issue a revised equitable division of the marital property.

(b) Significant Facts:

1. Curt and Diane were married on February 5, 2000.

2. Curt and Diane have two children, a son and daughter.

3. Curt filed the Complaint for Divorce on September 13, 2010.

4. Curt was 42 years old and Diane was 48 years and each were in good health. Their son was 11 years old and their daughter was 8 years old.

5. The 2004 Trust was an irrevocable trust established by Curt's father in 2004, a few years after Curt and Diane were married.

6. The 2004 Trust benefits an open class of beneficiaries composed of any one or more of the living issue of Curt's father with issue defined in The 2004 Trust as "the lawful blood descendants in the first, second, or any other degree" of Curt's father. At the time of separation, there were 11 discretionary beneficiaries.

7. The 2004 Trust was funded through shares of two for-profit education corporations, several life insurance policies, and a cash accounts.

8. The trustees are Curt's brother who is also a trust beneficiary, and a family attorney who is not a beneficiary.

9. Distributions to the beneficiaries may be made only with the approval of both trustees who

> "shall pay to or apply for the benefit of a class composed of any one or more of the donor's then living issue, such amounts of income and principal as the trustee, in its sole discretion, may deem advisable from time to time whether in equal or unequal shares to provide for the comfortable support, health, maintenance, welfare, and education of each or all members of such class."

10. The 2004 Trust contained a spendthrift provision pursuant to which

> "Neither the principal nor income of any trust created hereunder shall be subject to alienation, pledge, assignment, or other anticipation by the person for whom the same is intended, nor to attachment, execution, garnishment, or other seizure

under any legal, equitable, or other process."

11. From April, 2008 until August, 2010, Curt and his siblings received regular tax free distributions from the trust. (The court noted that the distributions were not taxable to the beneficiaries because Curt's father is responsible for taxes on any income earned by the trust, meaning the trust was an intentionally defective grantor trust.)

12. During this period, Curt received regular monthly distributions for a total of $800,000 in distributions.

13. Since the Complaint for Divorce was filed in September, 2010, Curt did not receive any distributions from The 2004 Trust and the trial judge found specifically that distributions to Curt ceased when he filed the Complaint for Divorce because the trustee deemed it too risky to distribute funds to Curt at a time when he might required to share the funds with Diane, a non-beneficiary.

14. The trustee continued to make distributions to Curt's two siblings.

15. The probate judge, Angela M. Ordonez, concluded that Curt's interest in The 2004 Trust should be included as part of the marital estate and awarded 60% of that to Diane taking into account Diane's "past, present, and future contributions and her lessened ability to acquire capital assets and work full time" which she contrasted with Curt's high salary, flexible work hours, and beneficiary status in his father's estate planning.

(c) Applicable Case Law Cited by the SJC:

1. Although a judge has considerable discretion in determining how to divide marital assets equitably, the question in this case is whether an interest in a trust is sufficiently similar to a property interest that may be included in a marital estate and thus subject to equitable division under G.L. 208, §34 and this is a question of law.

2. Because probate courts are not bound by traditional concepts of title or property, in considering whether a particular interest is to be included in the marital estate, we have held a number of tangible interests (even those not

within the complete possession or control of their holders) to be part of a spouse's estate for purposes of G.L. 208, §34.

3. If, however, an interest is characterized as a mere expectancy, they cannot be included in the divisible estate of the divorcing parties. Citing *Adams v. Adams*, 459 Mass. 361 (2011).

4. If an interest in a trust is determined to be too speculative or remote rather than fixed and enforceable, and thus more properly characterized as an expectancy, the interest is to be considered under G.L. 208, §34, criterion of "opportunity of each for future acquisition of capital assets and income in determining what disposition to make of the property that is subject to division (but not including the trust).

(d) Drafting Considerations:

1. In The 2004 Trust, the language of the trust included a so-called ascertainable standard which was cause for concern.

2. The trustee in its sole discretion could make a distribution of income and principal as it may deem advisable from time to time whether in

equal or unequal shares to provide for the comfortable support, health, maintenance, welfare, and education of each or all members of such class.

PLANNING NOTE:
This type of language should probably not be included. Use "income and principal payable to the beneficiary in the trustee's sole and absolute discretion" to avoid application of the Massachusetts Appeals Court decision in Comins v. Comins, 33 Mass. App. Ct. 28, 30-31 (1992) in which an interest in a discretionary trust with an ascertainable standard was deemed sufficiently certain to include the trust in the marital estate. In that case, the wife was the sole beneficiary of the trust, she received all of the trust income, and held power of appointment over the trust upon her death.

3. In this case, the SJC noted Curt was only 1 of 11 beneficiaries among an open class of beneficiaries and the trustees are required to take into account the trust's long term needs and assets unpredictably in the stock that funds it, the changing needs of the 11 current beneficiaries, and the possibility of additional beneficiaries. As such, Curt's present right to distributions from The 2004 Trust is speculative because the terms of the trust permit unequal distributions

among an open class that already includes numerous beneficiaries and because his right "to receive anything" is subject to the condition precedent of the trustee having first exercised his discretion "in determining the needs of an unknown number of beneficiaries."

(e) Interesting Note:

1. Diane won the case in the Probate Court and at the time the case was argued in the Appeals Court, two of the three judges who heard the arguments ruled in favor of Curt but, upon review by the full panel, this was reversed and the minority opinion became the majority opinion. The case was reversed on appeal by the Supreme Judicial Court.

2. At the time of the trial, the husband, through his attorney, identified the value of the trust as zero and ultimately was assessed at the time of trial $150,000 in legal fees for taking (Judge Kantrowitz and Judge Fecteau dissented) finding that the husband's interest in The 2004 Trust is too remote and speculative, too dependent in trustee's discretion, and too elusive of valuation to have been included in the marital estate for purposes of division.

II. Are Irrevocable Trusts Really Irrevocable? The asset protection benefits of decanting assets to a new trust. ***Morse v. Kraft*, 466 Mass. 92 (2013).**

(a) Overview:

If you have an irrevocable trust that does not contain appropriate spendthrift provisions or, if the trust will terminate at a date certain, and the assets will be paid over to the beneficiaries individually, and therefore would be subject to spousal claims as well as subject to any applicable estate taxes, consider decanting.

(b) *Morse v. Kraft*, 466 Mass. 92 (2013):

1. Richard Morse, trustee of the Kraft Irrevocable Trust ("The 1982 Trust") brought an action before the Single Justice of the Supreme Judicial Court pursuant to G.L. c.231, §1 and G.L. c.215, §6, asking the court's position to decant assets of The 1982 Trust into four new trusts, one for each child.

2. Procedurally, all the parties stipulated to the relevant facts and each of the defendants, with the exception of the Commissioner of Internal Revenue, assented to the relief sought.

PROCEDURAL NOTE:

The court has regularly recognized the appropriateness of granting declaratory relief to fiduciaries "seeking instructions concerning the manner in which an instrument… should be construed in connection with the possible application of federal estate tax provisions."

3. The 1982 Trust was established by Robert Kraft for his four children and consisted of four separate subtrusts within The 1982 Trust for the benefit of the four sons of Robert and Myra Kraft.

4. Each of the four sons was the beneficiary as to income and principal of his subtrust.

5. The sons children were the contingent remainder beneficiaries of the subtrusts and also are the potential objects of the sons power of appointment.

6. The plaintiff has served as the sole and disinterested trustee of The 1982 Trust and the four separate subtrusts.

7. The plaintiff is now 81 years old and is nearing retirement.

8. He proposes to transfer all of the property of the subtrusts into new subtrusts established in accordance with the terms of a new master trust for the benefit of each of the Kraft sons.

9. The court noted that the beneficiary of the original subtrust pursuant to The 1982 Trust, the Kraft sons and their children, are the beneficiaries of the new subtrusts pursuant to the 2012 Trust. See, *Phipps v. Palm Beach Trust Company*, 142 Fla. 782, 783-784 (1940)

10. The plaintiff contended that the transfer will only be in the beneficiaries best interest from a financial perspective if the transfer will not cause the property or distribution therefrom to be subject to the generation skipping transfer tax (GST).

(c) Decanting:

1. Decanting is the term generally used to describe the distribution of irrevocable trust property to another trust pursuant to the trustee's discretionary authority to make distributions "to or for the benefit of" one or more beneficiaries of the original trust.

2. Many states permit by statute a trustee to decant trust property from one trust to another but Massachusetts did not, and still does not, have any such provision.

3. The court noted that common law provides authority for decanting as well.

4. In effect, a trustee with decanting power has the authority to amend an unamendable trust in the sense that he or she may distribute the trust property to a second trust with terms that differ from those of the original trust.

5. In the ***Kraft*** case, the court determined that the trustee's decanting authority, in the absence of state statute, turns on the facts of the particular case and the terms of the instrument creating the trust. The exact language is as follows:

Article III. B:
"The trustee shall pay to the child (for whose benefit a subtrust is held) from time to time such portion or portions of the net income and principal as the disinterested trustee shall deem desirable for the benefit of such child…"

Article IV. A:
"Whenever a provision is made hereunder for the payment of principal or income to a beneficiary, the same may instead be applied for his or her benefit."

Article VII:
"The trustee shall full power to take steps and to do any action which they may deem necessary or proper in connection with the due care, management, and disposition of the property and the income of the trust thereunder… in their discretion without order or license of court."

6. The court noted that the trust did not state that the trustee could distribute property to a new trust for the benefit of The 1982 Trust beneficiaries expressly, but the plaintiff contended that the authority to distribute property in further trust is inherent in the broad language of the trust.

7. The court concluded that by the terms of The 1982 Trust, the plaintiff is authorized to transfer property in the subtrusts to the new subtrusts

without the consent of the beneficiaries or a court.

PLANNING NOTE:
The court declined a request of the Boston Bar Association, in its amicus brief, that it recognize an inherent power of trustees in irrevocable trusts to exercise their discretionary authority by distributing trust property in further trusts, irrespective of the language of the trust. In the absence of express authorizing legislation, practitioners should include express decanting provisions in standard trust agreements.

8. light of the increased awareness and indeed practice of decanting, we expect that settlors in the future who wish to give trustees a decanting power will do so expressly. We will then consider whether the failure to expressly grant this power suggests an intent to preclude decanting.

PLANNING NOTE:
From and after the date of the decision (July 29, 2013), a Massachusetts trust must expressly include the power to decant.

(d) Guardian ad Litem Discussion:

1. The parties filed a joint motion to waive the appointment of a guardian ad litem to represent the interests of the minor contingent remainder beneficiaries as well as the unborn and unascertained beneficiaries of The 1982 Trust.

2. The settlor assented and the court granted the motion for waiver of appointment, although the appointment of a guardian ad litem is typically the preferred practice.

3. The court noted, "As we perceived there to be no potential conflict of interest between parent and child on these facts, each minor beneficiary in this proceeding can be presented by his or her father." See, G.L. 190B, §1-403(2)(ii); G.L. c.203E, §303(6)

4. By extension, the fathers also can represent the interests of the unborn and unascertained beneficiaries as the interests of such beneficiaries are substantially similar to those of the minor beneficiary and there is no conflict of interest between the Kraft sons and any unborn or unascertained children.

III. How late is too late to act to decant? ***Ferri v. Powell-Ferri*, 476 Mass. 651 (2017)**

(a) Overview

1. Another divorce case but this time arising out of Connecticut where the divorcing parties lived and the interpretation of a Massachusetts trust was an issue.

2. The so-called 1983 Trust was settled by Paul J. Ferri for the sole benefit of his son, John Paul Ferri, Jr., when Ferri, Jr. was 18 years old.

3. The trust was created in Massachusetts and was governed by Massachusetts law.

(b) Distribution Provisions and the Divorce:

1. The 1983 Trust establishes two methods by which assets are distributed to the beneficiary:

- first, the trustee may pay to or segregate irrevocably "trust assets for the beneficiary";

- second, after the beneficiary reaches the age of 35, he may request certain withdrawals up to a fixed percentage of

assets increasing from 25% of the principal at age 35 to 100% after age 47.

2. The wife filed for divorce in October, 2010, in the Connecticut Superior Court to dissolve the marriage.

3. In March, 2010, the trustees of The 1983 Trust, Michael J. Ferri and Anthony J. Medaglia, created a new trust for the benefit of Paul John Ferri (The 2011 Trust) and subsequently distributed substantially all of the assets of The 1983 Trust to themselves as trustees of The 2011 Trust.

4. As with The 1983 Trust, Ferri, Jr. is the sole beneficiary of The 2011 Trust.

5. The 2011 Trust is a spendthrift trust and the trustee may exercise complete authority over whether and when to make payments to the beneficiary, if at all, and the beneficiary has no power to demand payment of trust assets.

6. The trust contained a broad spendthrift provisions and the trustees acknowledged that the trustees decanted The 1983 Trust out of

concern that the wife would reach the assets of The 1983 Trust as a result of the divorce action.

7. This was undertaken without informing the beneficiary and without his consent.

8. At the time of decanting, Ferri, Jr. had a right to request a withdrawal of up to 75% of the principal from The 1983 Trust.

9. During the course of the action, his vested interest matured into 100% of the assets of The 1983 Trust.

(c) Procedural History:

1. In August, 2011, the plaintiff/trustees of The 1983 Trust and The 2011 Trust commenced a declaratory judgment action against the husband and wife in the Connecticut Superior Court seeking a declaration that; (1) the trustees validly exercised their powers under The 1983 Trust to distribute and assign the property and assets held by them as trustees of The 1983 Trust to The 2011 Trust, and (2) wife had no right, title, or interest directly or indirectly in or to The 2011 Trust or its assets, principal, income, or other property.

2. Wife moved for summary judgment and summary judgment was awarded by the Trial Court in Connecticut.

3. The Connecticut Supreme Court, however, certified three questions to the Massachusetts court relative to the authority of a trustee to distribute substantially all of the assets of an irrevocable trust into another trust, in other words decant.

- Question 1: Under the Massachusetts law, did the terms of the Paul John Ferri, Jr. 1983 Trust empower its trustees to distribute substantially all of its assets, that is to decant, to the Declaration of Trust for Paul John Ferri, Jr., The 2011 Trust?

- Question 2: Under Massachusetts law, should a court in interpreting whether The 1983 Trust's settlor intended to permit decanting to another trust consider an affidavit of the settlor… offer to establish what he intended when he created The 1983 Trust.

4. The Supreme Judicial Court answered yes to both questions.

(d) Interesting Discussion:

1. As to the fact that the beneficiary had the right to withdraw, the court simply stated that "All of the powers of the trustee over the property remain vested in the trustee until such time as the right to withdraw is exercised."

2. "When a trust terminates, the beneficiaries obtain a vested interest in the trust property that is not unlike the beneficiary's withdrawal rights here. Notwithstanding this vested right, however, the trustee of a terminated trust retains ongoing duties to control and protect the trust assets and may continue to act pursuant to the powers provided under the trust instrument." Citing, *Rothwell v. Rothwell*, 283 Mass. 563, 570, 572 (1933); (Following a trust termination date, the duties and powers of the trustees do not cease until the property is conveyed and, until such conveyance, "The trustees have power to perform an act incidental to the conservation of the trust property."

3. As to the settlor's intent, the court followed on the Morse suggestion that the settlor's intent to decide whether decanting was within the permissible scope of the trustees powers.

4. The settlor's affidavit in this case, dated July 11, 2012, states:

> "I intended to give to the trustees of The 1983 Trust the specific authority to do whatever he or she believed to be necessary and in the best interest of my son, John Paul Ferri, Jr., with respect to the income and principal of The 1983 Trust, notwithstanding any of the other provisions of The 1983 Trust… Therefore, if the trustee thought at any time that the principal and income of The 1983 Trust could be at risk, the trustee could take any action necessary to protect the principal and income of The 1983 Trust… This authority to protect assets would also extend to a situation where creditors of Paul John Ferri, Jr. may attempt to reach the assets of The 1983 Trust, such as in the event of a law suit or a divorce"

PLANNING NOTE:

If you are serving as a trustee and the trust is going to terminate because of the death of the grantor and/or the grantor's spouse, you may and probably must at least consider decanting assets to a continuing trust. This would also be important in the time of estate tax repeal to protect the assets from being subject to estate taxes in subsequent generations.

IV. Non-judicial Settlements

(a) Introduction:

1. Massachusetts adopted its version of the Uniform Trust Code effective July 8, 2012.

2. Scope: The MUTC applies to express trusts, charitable, and noncharitable trusts of a donative type.

3. Caveat:

a. A Massachusetts nominee trust or realty trust does not have gift-over and in which the trustee can only do as directed by the beneficiaries is not a trust of the donative nature and therefore is not subject to or covered by the Uniform Trust Code.

b. The relationship between a trustee and the beneficiaries of a realty trust or a nominee trust is that of an agent/principal.

c. Effective Date; except as otherwise specifically provided, the MUTC applies to all trusts created before, on, or after the effective date.

PLANNING NOTE:
Revocable or Irrevocable? Unless the terms of a trust expressly provide that the trust is irrevocable, the settlor may revoke or amend the trust. This subsection does not apply to a trust created under an instrument executed before the effective date of the MUTC (July 8, 2012). MUTC Section 602(A). Under this, a trust is revocable unless the instrument specifically provides otherwise.

(b) Non-judicial Modifications:

1. A non-judicial settlement is valid only to the extent that it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by a court. MUTC Section 111(c)

2. Matters that may be resolved by non-judicial settlement agreement include:

a. the interpretation or construction of the terms of the trust;

b. the approval of a trustee's report or accounting;

c. direction to a trustee to refrain from performing a particular act or the grant to a trustee of any necessary or desirable power;

d. the resignation or appointment of a trustee and the determination of a trustee's compensation;

e. the transfer of a trust's principal place of administration; and

f. the liability of a trustee for an action relating to a trust. MUTC Section 111(d)

Example:

1. Assume that a trust provides that upon the death of the settlor property on Nantucket will be divided into equal shares, one share for the benefit of each living descendant, and then the trust provides that the property shall be held by the trustee for the benefit of such descendants and does not contain any power to sell.

2. Assume the beneficiaries wish to sell the property and the trustee is in agreement.

- Question: Can this problem be resolved with a non-judicial settlement?

- Answer: It depends upon whether the document is a material purpose. If it is a material purpose, judicial modification will be necessary.

Caveat: Material purpose is not defined.

(c) Who must agree?

1. Except as otherwise provided in the subsection regarding a "material purpose" of the trust, interested persons may enter into a nonbinding judicial settlement agreement with respect to any matter involving a trust. MUTC Section 111(b)

2. For purpose of this section, "interested persons" means persons whose consent would be required to achieve a binding settlement were the settlement to be approved by the court.

PLANNING NOTE:
This means all beneficiaries would be considered interested persons but with virtual representation.

(d) Virtual Representation:

1. Sections 301, 302, and 303 provide virtual representation for notice and consent for both non-judicial settlements and judicial proceedings.

2. Virtual representation was a change in Massachusetts brought with the Massachusetts Uniform Probate Code.

3. These provisions are consistent with the laws of many states and with the Massachusetts Uniform Probate Code and, in many instances, the need for guardians ad litem will be eliminated.

(e) Representation by Fiduciaries:

1. To the extent there is no conflict of interest between the representative and the person represented or among those being represented with respect to a particular question or dispute; (1) a conservator may represent and bind the estate that the conservator controls; (2) a guardian may represent and bind the ward within the scope of the guardian's powers and duties; (3) an agent having authority to act with respect to the particular question or dispute may

represent and bind the principal; (4) a trustee may represent and bind the beneficiaries of the trust; (5) a personal representative of a deceased estate may represent and bind persons interested in the estate; and (6) a parent may represent and bind the parent's minor or unborn child if a conservator or guardian for the child has not been appointed. MUTC Section 303(1 - 6)

V. Trustee's Duty to Inform and Report, MUTC Section 813:

(a) Overview

1. A trustee shall keep "qualified beneficiaries" of the trust reasonably informed about the administration of the trust.

2. Unless unreasonable under the circumstances, a trustee shall promptly respond to a qualified beneficiary's request for information related to the administration of the trust. MUTC Section 813(a)

3. Within 30 days after acceptance of the trust or the trust becomes irrevocable, whichever is later, the trustee shall inform in writing the qualified beneficiaries of the trust, trustees name and address. This information shall be delivered or sent by ordinary First Class Mail. MUTC Section 813(b)

4. A trustee shall send an account to the distributees or permissible distributees of trust income or principal and to other qualified beneficiaries who shall request it, at least annually and at termination of the trust.

5. The account may be formal or informal but shall include information relating to the trust property, liabilities, receipts, and disbursements, including the amount of the trustee's compensation, a listing of the trust assets, and, if feasible, their respective market values. MUTC Section 813(c)

Caveat:

The term "qualified beneficiary" is somewhat ambiguous and subject to debate. A qualified beneficiary means a beneficiary who, on the date of the beneficiary's qualification, is determined; (a) a distributee or permissible distributee of trust income or principal, or (b) would be a distributee or permissible distributee of income or principal if the trust terminated on that date. MUTC Section 103(10): Definitions

Example:

1. Trust provides that income is payable to the surviving spouse and principal is payable to the surviving spouse in the trustee's discretion. Upon the death of the surviving spouse the assets

are to be paid over to the remainder beneficiaries (meaning the 3 children).

2. Are the 3 children entitled to accounts?

3. By right, are the children so-called qualified beneficiaries who can request an accounting?

4. The planning notes indicate that the committee recognizes that such a request is implicit in the language of subparagraph A, absent unusual circumstances or a "prohibition in the trust instrument itself."

PLANNING NOTE:

1. The comments state: "qualified beneficiaries is an important definition determining those beneficiaries entitled to notice and is limited to those currently as eligible to receive income or principal and to those who would be entitled to receive income and principal if the trust then terminated."

2. The committee noted that their rewriting "eliminated from the definition of qualified beneficiaries entitled to notice any intermediate tier of successive income or principal beneficiaries who will be eligible to receive distributions of the prior income interest terminated," but the trust did not terminate.

(b) Estate Tax Inclusion:

PLR 201233008 - stands for the proposition that grantor's consent to a non-judicial settlement does not cause estate tax inclusion under 2036 or 2038 and that it is not a gift under 2501. The PLR also cites to Treas. Reg. Section 20.2038-1(a)(2) which provides that 2038 does not apply when a decedent's power can only be exercised with the consent of all parties having an interest in the property.

(c) Malpractice Insurance:

It would be advisable to obtain errors and omissions insurance as a condition to serving as a trustee. The trust should authorize the acquisition of such insurance at the trust's expense using perhaps the following language:

> .33 To acquire any errors and omissions insurance or the equivalent, as determined by the Trustee, in such amount and on such terms as the Trustee deems reasonably necessary at the expense of the Trust.

VI. Is a Life Estate a Property Interest or an Interest in Trust for Medicaid Eligibility Purposes? The Supreme Judicial Court is About to Rule.

(a) Introduction and Overview:

In order to protect assets from the costs of long term care, income only irrevocable Medicaid trusts are recommended. Generally, income is payable to the settlor while distributions of principal are prohibited. Because distributions of principal are prohibited, the principal of the trust is considered protected and not a countable asset for purposes of MassHealth/Medicaid eligibility.

1. In *Daley v. Sudders*, No. 15-0188 (Worcester Superior Court, 12/23/2015) the Superior Court concluded that the retention of a life estate caused the applicant's home otherwise transferred to an income only irrevocable trust, to be a countable asset holding as follows:

> "Property held in an irrevocable trust is a countable asset where it is available according to the terms of the trust" 130 CMR 520.023(C)(1)(d) Citing, *Doherty v. Dir. of Office of Medicaid*, 74 Mass. App. Ct. 439, 441 (2009) If a Medicaid applicant can use

and occupy her home as a life tenant, then her home is “available. This has been appealed and argued before the Supreme Judicial Court on January 5, 2017.

2. Leo J. Cushing, Esq., as Chair of the Estate Planning, Trusts & Estate Administration Committee, on behalf of the Real Estate Bar Association, filed an amicus brief in support of the appellant, Mary E. Daley, arguing that a life estate is a property interest not an interest in trust.

3. See Article entitled “Life Estates, A Property Interest or Interest in Trust”

VII. Dealing With Digital Assets

1. On February 21, 2017, the Cyberlaw Clinic filed an amicus brief on behalf of several trusts and estates law scholars and practitioners in Ajemian v. Yahoo!, Inc., Mass. Supreme Judicial Court No. SJC-11917.

2. The Ajemian case arises out of a dispute between Yahoo and the family of John Ajemian, who died unexpectedly in 2006.

3. After Mr. Ajemian's death, the administrators of his estate contacted Yahoo about gaining access to his email account.

4. Yahoo refused, claiming that the Stored Communications Act (SCA), 18 U.S.C. § 2701 et seq., prevented it from doing so.

5. Among other things, Yahoo argued that the "lawful consent" exception found in § 2702(b)(3)—authorizing providers to disclose stored communications "with the lawful consent of the originator or an addressee or [the] intended recipient"—requires the express consent of the user.

6. Since Mr. Ajemian died intestate and did not otherwise authorize the post-mortem disclosure of his email, Yahoo contents his estate is forever barred from accessing it.

7. This appeal focuses solely on the question of how to interpret the SCA's lawful consent provision, and we believe that it is a case of first impression in the United States.

8. The amicus brief argues that Yahoo's proposed interpretation of the SCA would frustrate the efficient administration of estates and prevent families from accessing troves of data with financial and sentimental value that are increasingly stored only on the servers of private companies like Yahoo.

9. While acknowledging that the SCA protects important privacy interests, the brief suggests that the court need not read the SCA as dogmatically as Yahoo suggests, especially since the statute was written over 30 years ago and is silent on this particular issue.

10. Yahoo's reading would create a default rule that anyone who dies "digitally intestate"—that is, without leaving express instructions about

what to do with their electronic accounts—wishes their data to forever remain beyond the reach of their relatives.

PLANNING NOTE:
While this case is pending, the following language is suggested in the Trust and Power of Attorney:

Digital Assets

.31 The Trustee shall have the power to access and take control of the Donors' "digital assets," as hereinafter defined, to categorize the same as tangible personal property or personal assets (tangible or intellectual) as appropriate, and to have all powers with respect to such "digital assets" as are necessary and/or appropriate to facilitate the proper administration and distribution of the Donors' estate, including, but not limited to having access to any and all passwords associated with such digital assets. The term "digital assets" shall include information and property, including files stored on the Donors' digital devices or files stored elsewhere, including but not limited to, servers, "the cloud," or other cloud service, desktops, laptops, tablets, peripherals, storage devices, mobile telephones, smartphones, and any similar digital device which currently exists or may exist as technology develops or such comparable

items as technology develops. The term "digital assets" also includes but is not limited to usernames, passwords, emails sent or received, email accounts, digital music, digital photographs, digital videos, software licenses, social network accounts and databases, file sharing accounts, financial and investment accounts, domain registrations, Domain Name System (DNS) service accounts, web hosting accounts, tax preparation service accounts, online merchants, affiliate programs, other online accounts and similar digital items which currently exist or may exist as technology develops or such comparable items as technology develops, regardless of the ownership of the physical device upon which the digital item is stored. This clause is specifically meant to include Facebook, YouTube, Twitter, Instagram, Amazon, blogs and the like. Any company, entity, website, webmaster and network administrator shall disclose anything (including, again, username and passwords) as requested by the Trustee without any right to the Donors' privacy.

VIII. Domestic Asset Protection Trusts

(a) Introduction

On September 9, 2008, New Hampshire enacted one of the most advanced asset protection statutes in the country. No longer will you need to look to establish off shore trusts or consider either Alaska or Delaware. You can now place your assets in a trust using New Hampshire's new Qualified Dispositions in Trust Act. Effective for transfers into trust occurring on or after January 1, 2009, you can now establish a trust in which you can be a beneficiary, not just your family members. New Hampshire Statutes Ch. 564-D, Qualified Dispositions in Trust Act.

(b) Background & History

Asset protection with self-settled trusts has been somewhat problematic as a result of two Massachusetts cases decided years ago. In *Ware v. Gulda* 331 Mass. 68 (1954), the Massachusetts Supreme Judicial Court ruled that assets in an irrevocable trust would be subject to the settlor's creditors, if the settlor is a beneficiary even if the settlor does not have the right to request or demand distributions. The Court ruled that, in

determining the extent to which the assets would be subject to the settlor's creditors, Courts will presume the maximum degree of discretion by the trustee, even if the trustee is unrelated to the settlor and independent. *State Street Bank & Trust Company v. Reiser*, 7 Mass. App. 633 (1979), Rev. Rul. 76-103; Rev. 77-378.

For example, if you set up a trust with an independent trustee, which provides that income and/or principal of the trust is payable to or for the benefit of the settlor in the trustee's sole and absolute discretion, specifically prohibits the settlor from requesting or demanding distributions, these trust assets nevertheless will be considered payable to satisfy the settlor's creditors.

These Massachusetts court decisions became the basis for the law of the land. As a result, in a state which has not effectively repealed the mandates of the Massachusetts court decisions, so-called "self-settled" trusts will not protect the assets from the claims of the settlor. There were essentially two options, one is to establish an irrevocable trust for the benefit of the settlor's spouse and/or children where the settlor is not a beneficiary and cannot receive distributions under any circumstances or the other option is to consider an off shore trust.

Off shore trust planning has become problematic as a result of certain criminal sanctions imposed on settlors. In the United States, Alaska was the first state to enact a law repealing the self-settled trust rule and was quickly followed by Delaware and even Rhode Island enacted a similar statute recently. Now, New Hampshire also permits self-settled asset protection trusts, also known as domestic asset protection trusts ("DAPT").

It should also be noted that New Hampshire also repealed its rule of perpetuities for transfers occurring on or after January 1, 2004, so that, once assets are placed in trust, the assets can remain in trust forever and avoid gift and estate taxation upon subsequent generations and avoid creditors of all lineal descendants. See NH RSA 546:24

(c) Technical requirements

In order to establish a New Hampshire DAPT, a donor, known as the settlor/trustor, creates a trust instrument that appoints a qualified trustee to hold the property that is the subject of the so-called "Qualified Disposition." The trust must (a) expressly incorporate the law of New Hampshire to govern the validity, construction, administration

of the trust, (b) be irrevocable, and (c) provide that the interest of the transferor or other beneficiary of the trust property or the income therefrom may not be transferred, assigned, pledged, or mortgaged, whether voluntarily or involuntarily, before the qualified trust or qualified trustee actually distributes the property or the income therefrom to the beneficiary. This provision is known as a spendthrift provision and is deemed to be a restriction on the transfer, assignment, pledge, or mortgage of the transferor's beneficial interest in the trust. Neither the Donor nor the Beneficiaries need to be New Hampshire residents. New Hampshire Statutes, Ch. 564-D; 2 I.

The law then provides for a number powers that can be retained by the transferor or powers given to the trustee or a third party which do not statutorily undermine the spendthrift provision including:

- A power to veto a distribution from the trust;

- A so-called limited Power of Appointment to appoint the trust property at death or, as of 2011, even during life;

- The right to remove a trustee or trust advisor and appoint a new trustee or trust advisor, other than a person who is related to or subordinate to the transferor

- And most importantly, the right to potential or actual receipt or use of principal, if such potential or actual receipt of use of principal would be the result of a qualified trustee, including a qualified trustee or a qualified trustee acting at the direction of a trust advisor, acting either in such qualified trustee's sole discretion or pursuant to an ascertainable standard in the trust instrument. New Hampshire Statutes, Ch. 564-D; 2 II

(d) Concern Over the Trustee's Decision-Making Process

The trustee of the New Hampshire DAPT must be a person other than the transferor who, in the case of a natural person, is a resident of New Hampshire or who, in all other cases, is a state or federally chartered bank or trust company,

1. having a place of business in New Hampshire;

2. is authorized to engage in a trust business in New Hampshire;

3. maintains or arranges for custody in the state of some or all of the property that is the subject of the qualified disposition;

4. maintains records in the state for the trust on an exclusive or non-exclusive basis;

5. prepares or arranges for the preparation in New Hampshire of fiduciary income tax returns for the trust; and

6. otherwise materially participates in the state in the administration of the trust.

New Hampshire Statutes, Ch. 564-D; III

(e) Role of the Trust Advisor

New Hampshire legislature, understanding obvious concern over the corporate fiduciaries, solved this problem by allowing the transferor to appoint a so-called trust advisor. The statute provides that nothing would preclude the transferor from appointing one or more trust

advisors, including trust advisors who have authority under the terms of the trust instrument to remove and appoint qualified trustees and/or trust advisors; and trust advisors who have authority to direct, consent to, or disapprove distributions from the trust. The transferor may serve as a trust advisor.

(f) Limitations on Creditor's Right

A transferor's transfer of property to a New Hampshire DAPT will extinguish any creditor's claim, unless the creditor's claim arose before the qualified disposition was made and an action is brought within the limitations of RSA 545-A (Uniform Fraudulent Transfers Act), in effect on the date of the qualified disposition, or notwithstanding the UFTA, the creditor's claim arose on or after the date of the qualified disposition and the action is brought within four years after such date. Ch.564-D; 10.

The period of limitations as set forth in the Uniform Fraudulent Transfer Act is generally four years, or the creditor's claim arose on or after the date of the qualified disposition and the action is brought within four years of such date.

(g) Balance Sheet & Financial Statements

The individual financial statement should not include assets transferred to the New Hampshire DAPT since the transferor's beneficial interest in the trust is technically property owned by the trust after the transfer. Failing to properly prepare financial statements reflecting the ownership of assets in a New Hampshire DAPT could be a basis for misrepresentation as to the underlying obligation.

(h) Spouses

In addition to the foregoing types of claims, the New Hampshire DAPT trust assets would be subject to the claims of a spouse or a former spouse as of the date of the transfer on account of an obligation arising under a prenuptial agreement or an agreement or court order for the payment of support or alimony in favor of such transferor's spouse, former spouse, or children, or for the division or distribution of property in favor of such transferor's spouse or former spouse, but only to the extent of such debt. This provision, however, applies *only to a spouse to whom the transferor was married or divorced on the date of the qualified disposition.*

A transferor who is single, who makes a qualified disposition and then marries is not subject to these provisions. Additionally, any person who suffers death, personal injury, or property damage, on or before the date of a qualified disposition by a transferor, which death, personal injury, or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person or whom such transferor is or was vicariously liable, is exempt from the provisions.

(i) Income Taxes

The DAPT can save state income taxes. New Hampshire has state income tax only on interest and dividends, but since 2013, this tax has not applied to non-grantor trusts. Thus, interest and dividends are only taxable in the case of grantor trusts or when the interest and dividends are passed through a trust to a beneficiary who is a New Hampshire resident or inhabitant. Additionally, New Hampshire does not tax capital gains.

Despite these tax benefits, it might be advisable to draft the DAPT as an intentionally defective

grantor trust. If the trust is a grantor trust, income and capital gains will be taxable to the grantor since the grantor trust is ignored for income tax purposes. Perhaps use the IRC § 675(4)(C) power to reacquire trust assets in a non-fiduciary capacity. If the DAPT is a grantor trust, the trustee is permitted to reimburse the grantor the incremental income taxes incurred as a result of the grantor trust income. Rev. Rul. 2004-64

(j) Gift Taxes

A DAPT can be drafted to be either a completed gift or an incomplete gift. If the grantor retains a limited power to appoint principal by Will upon the grantor's death, the transfer to the trust will be an incomplete gift. Note that reserving a limited power to appoint principal by Will would not make the trust a grantor trust. PLR 200531004; 200523003. If the transfer is a completed gift, a gift tax return will need to be filed. In PLR 9837007, the IRS ruled that a transfer through an Alaska DAPT was a completed gift, but refused to rule on the question of estate tax includibility.

(k) Estate Taxes

A DAPT drafted to be a completed gift should also be excluded from the decedent's estate. While the IRS has refused to rule in private letter rulings on the includability of a specific trust in the gross estate of a taxpayer, in private letter rulings the IRS has indicated that a properly managed trust would be excluded from a decedent's gross estate following the rationale of Rev. Rul. 2004-64. See PLR 200944002.

(l) Federal Bankruptcy Limitations

There are two issues in terms of bankruptcy of the grantor. The first issue is whether the trust assets become part of the bankruptcy estate and the second issue is whether the transfer to the trust can be set aside by the bankruptcy trustee. It seems clear that the trust assets do not become part of the bankruptcy estate pursuant to Bankruptcy Code Section 541(c)(2), which provides:

"A restriction on the transfer of the beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title." See, *Patterson v. Shumate*, 504 U.S. 753 (1992)."

As to the trustee's ability to set aside a transfer, Section 548(e) provides the following:

(e)(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within ten years before the date of the filing of the petition, if (A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the Debtor is a beneficiary of such trust, or similar device; and (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

(m) Rule of Perpetuities Not Applicable to New Hampshire Trusts

Since New Hampshire repealed its rule of perpetuities in 2004, a DAPT can be structured to last forever.

IX. Guidelines for Changing Domicile

1. Introduction

(a) Income Taxes:

Massachusetts residents are subject to Massachusetts income taxes on income from whatever source derived while nonresidents are subject to income tax only on income from sources within Massachusetts.

(b) Estate Taxes:

A Massachusetts resident is liable for the Massachusetts estate tax on all assets (with the statutory exception of property located outside of Massachusetts) while nonresidents are subject to estate taxes only with respect to real estate and tangible personal property located in Massachusetts.

(c) Statutory Definition:

With respect to income taxes, M.G.L. c.62, §1F provides as follows:

> "A resident or inhabitant is defined as (1) any natural person domiciled in the Commonwealth, or (2) any natural person who is not domiciled in the Commonwealth but who maintains a permanent place of abode in the commonwealth and spends in the aggregate more than one hundred eighty-three days of the taxable year in the commonwealth, including days spent partially in and partially out of the Commonwealth. For purposes of clause (2), a day spent in the commonwealth while on active duty in the armed forces of the United States shall not be counted as a day in the commonwealth. The word "non-resident" shall mean any natural person who is not a resident or inhabitant."

With respect to estate taxes, M.G.L. c.65C, §1(i) provides that a resident is "any person domiciled in the Commonwealth"

Comment: Unfortunately, the Massachusetts statutes do not define the term "domicile" but, in a Technical Information Release, T.I.R. 95-7, the Department of Revenue noted that a person can have only one domicile, but can have many places of residence. In

general, the test is a subjective test rather than an objective test and requires "physical presence out of Massachusetts plus the intent to permanently reside in a state other than Massachusetts." The burden of proof will be on the taxpayer to establish that the domicile is changed from Massachusetts.

2. Steps to be Taken

(a) Register to Vote: Register to vote in the new state of domicile and be sure to withdraw name from the Massachusetts voters list.

(b) Vehicle Registration: Change address for automobile, boat and/or other vehicles requiring registration to the new state of domicile.

(c) Drivers License: be sure to obtain a drivers license from the new state of domicile and also be sure to give up the Massachusetts license together with some correspondence that a change in domicile has occurred.

(d) Clubs and Organizations: Be sure to become actively involved in clubs and organizations in the new state of domicile; activities relative to Massachusetts clubs and organizations should be

minimal; Be sure to change mailing addresses for all clubs and organizations to the new state of domicile.

(e) Doctors and Hospitals: Be sure to change all of your personal physicians to the new state of domicile

(f) Massachusetts Businesses and Real Estate: All documents relative to any business in Massachusetts should reference the new state of domicile as the mailing address. This includes filings with the Secretary of State and otherwise. The individual should not actively participate in any official capacity such as an officer or on the board of directors. But, if the taxpayer remains involved as an officer, the mailing address should be changed to the new state of domicile.

(g) Passports: An attempt should be made to change the residence listed on your passport or, at a minimum, be sure that any new application for passport reflects the new state of domicile.

(h) Estate Planning Documents: In connection with the change in domicile, all estate planning

documents should be updated to reflect the applicable laws of the new state of domicile.

(i) Acquiring Real Estate: As property is acquired in the new state of domicile, steps should be undertaken to declare a homestead and file whatever paperwork is necessary with the local authorities to establish domicile and minimize property taxes.

(j) Banking: All significant banking should take place in the new state of domicile rather than with Massachusetts based banks and, at a minimum, all investment accounts and/or bank accounts should reflect a change of address to the new state of domicile.

(k) Life Insurance and Other Investment Accounts: Be sure that all addresses listed on insurance policies and investment accounts reflect the new state of domicile.

(l) Tax Filings: All tax filings should reflect the new state of domicile. Note, however, that if the former Massachusetts resident has income considered Massachusetts source (such as real estate), a nonresident income tax return nevertheless will need to be filed.

(m) Keep a Log: For those taxpayers who are sensitive to the 183 day requirement, it would be important to maintain a log of days in the new state of domicile and/or in Massachusetts. Keep flight records, itineraries, and other documents such as credit cards. Perhaps use a credit card to buy even small items such as a newspaper and/or a cup of coffee each and every day while out of Massachusetts.

(n) Telephone Records: Be sure that most telephone calls reflect use from the new state of domicile inasmuch as cell phone records and land line records can be used to show that the taxpayer has not really changed their domicile.

(o) Commercial Real Estate: Remember, a change in domicile for estate tax purposes does not prevent Massachusetts from to assessing an estate tax against so-called Massachusetts real estate and Massachusetts tangible property located in Massachusetts. For this reason, in connection with a change in domicile, it is important for the taxpayer to convert the real estate in Massachusetts to an LLC which is deemed to be an intangible or, to the extent that the property is residential, consider transferring it

to an irrevocable trust and lease back the property.

(p) Married Filing Separately: If only one spouse changes domicile, be sure that income tax returns are filed as “married filing separately”.

X. IRC § 2704: Bye, Bye Discounts?

(a) Staying in Control

1. The commercial real estate would be contributed to an LLC with nonvoting and voting units established on a 9 to 1 radio (900 nonvoting units and 100 voting units)

2. Then, the nonvoting units would be gifted to a trust for the benefit of the client and future descendants (a so-called New Hampshire Domestic Asset Protection Trust "DAPT") up to the estate and gift tax exemption ($5,430,000 for 2015)

3. Due to lack of control and lack of marketability, the nonvoting units would be valued at a 35% discount from the net asset value

- See, *Lappo v. Commissioner*, T.C. Memo 2003-258 (15% minority interest discount and 24% marketability discount); *Peracchio v. Commissioner*, T.C. Memo 2003-280 (6% minority interest discount and 25% marketability discount)

4. None of the voting units are gifted, meaning all business decisions are in his sole control.

(b) Background

1. On August 2, 2016, the Internal Revenue Service issued Proposed Regulations which would deny any discounts for gifts of minority and/or nonvoting interests in family businesses.

2. The Regulations will not become effective until the IRS publishes them as final.

3. The earliest date was December 1, 2016.

(c) IRC § 2074

1. On October 28, 2016, Attorney Luke Bean, (attendee) and Leo J. Cushing, (speaker), attended the 42nd Annual Notre Dame Tax and Estate Planning Institute in South Bend, Indiana.

2. Our excellent luncheon speaker was Attorney Catherine Hughes, the IRS (Treasury) Attorney responsible for drafting, reviewing comments and implementing the final IRC 2074 Regulations limiting discount planning.

3. After listening to Attorney Hughes (and numerous other speakers on this topic) it is clear that no one was better able to speak on behalf of the IRS about the current status and intended goals of the regulations. Several important points were made.

4. First, there is no predetermined date to make the Regulations final such as before the election and/or before the inauguration.

5. In this regard, over 3,600 comments have been received so far and it is not likely that the Regulations will become final until well after the first of the year notwithstanding the public hearing on December 1, 2016.

6. Her quote was that they will not become final until we "get them right."

7. The good news here is that the deadline for taking action likely will not be December 1, 2016 but sometime after the first of the year, although for those undertaking a plan, there is no reason to delay implementation.

8. Several other points were made.

9. They do not intend to eliminate all discounts and there may be an exclusion for a so-called "operating business" although admittedly this is not what the Proposed Regulations say.

10. There currently is no exception for an "operating business" nor is there a provision for allowing even small discounts.

11. For these reasons, it is likely that the Proposed Regulations will undergo significant modification.

12. The time to act, however, is now since the one thing that remains clear is that the final Regulations will significantly curtail discount planning.

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Attorney Luke C. Bean is an associate in the Estate Administration and Tax Planning Group at Cushing & Dolan, P.C. He concentrates on estate planning matters by developing strategies to transfer wealth efficiently using sophisticated planning techniques that defer or eliminate taxes. He also focuses on tax aspects of estate administration, assisting clients in fulfilling their obligations after the passing of a loved one.

Prior to joining Cushing & Dolan, P.C., Luke worked at Boston Legacy Planning, LLC. There he was responsible for the design and drafting of estate plans for clients with an emphasis on probate avoidance and creditor protection. Luke was also previously with the firm of Withers Bergman LLP where he handled a variety of complex personal, corporate, estate and gift tax matters for clients. Additionally, Luke has experience in the areas of business succession planning, elder law, probate litigation, tax controversy, 501(c)(3) organizations and charitable gift planning.

Luke graduated from The Pennsylvania State University in 2009 with a degree in Economics, and is a graduate of Boston College Law School, Class of 2012, Magna Cum Laude, Order of the Coif. He also earned an LL.M. in Taxation at Boston University School of Law, graduating second in his class.

Estate Tax Planning Techniques in an Estate Tax Repeal Environment: Building a Wall to Protect Assets from Future Uncertainty

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1. Introduction

The first 100 days of Donald J. Trump's Presidency have just passed and things have been unpredictable, to say the least. With respect to taxes, on Wednesday April 26th, Donald Trump released his proposal for overhaul of the tax code, which proposes significant changes to the entire tax code, not the least of which is a bullet included in the one-page outline of his plan which would "repeal the death tax" – namely the federal estate tax regime currently in place. Leading up to Wednesday's announcement, a number of bills have also been put forth before both the House and Senate similarly proposing repeal of the federal estate tax and its counterparts, the gift and generation skipping transfer tax regimes.

Presently, the federal estate tax exclusion amount is $5,490,000 and the annual exclusion amount for gifts is $14,000 per donor, per recipient.

Since a repeal of the estate, gift, or generation-skipping taxes would significantly impact current approaches to estate and tax planning, the potential repeal has many professionals wondering what the best course of action is in light of such uncertainty. Notably, the estate tax has been enacted, modified, and repealed many times throughout its history indicating there is a good chance that, if repealed, a new estate tax regime may be enacted in the future. Therefore, it is critical to plan now not only for potential repeal of these tax regimes, but also their probable re-enactment in some form in the future.

2. A Brief History of the Taxation of the Transfer of Property at Death in the United States

a. A Contentious Beginning

At its founding, the United States did not impose a tax on the transfer of assets at death. However, this changed when the United States needed to fund wars and conflicts. During such times, namely 1797-1802, 1862-1870, and 1898-1902, death taxes were implemented to provide extra revenue and then were subsequently repealed when the war or conflict concluded.

The first of these taxes, passed as part of the Stamp Act of 1797, was a federal stamp on probated wills, inventories, and letters of administration. The revenue raised paid the country's debts incurred while in conflict with France in 1794 and strengthened the country's military and defensive position. These stamps were repealed by Congress in 1802 after the conflict ended.

The next imposition of a death tax came as part of the Revenue Tax Act of 1862 to help finance the Civil War which imposed new taxes on the northern states, including a federal inheritance tax. Unlike the stamp tax which was based on probate documents filed and paid by the estate, the inheritance tax was imposed on the receipt of personal property from the decedent and was paid by the recipient. The tax rate was based on the recipient's relationship to the decedent rather than the value of property received. As the Civil War continued, rates increased. In 1864, Congress enacted an additional federal succession tax on real property including assets passed at death by operation of law, such as due to a life tenancy or joint tenancy, and gifts made during the decedent's life. This created the first gift tax in the United States. Each of these taxes had certain exceptions based upon the beneficiary's relationship to the decedent. In recognition of the public's resistance to such taxes, Congress set an expiration on the taxes, but ultimately repealed the taxes prior to their planned expiration once the Civil War ended and the debts were satisfied. These taxes, including the inheritance tax, were challenged by taxpayers but withstood most challenges, and, following the passage of the Sixteenth Amendment, Congress had the clear authority to impose taxes on transfers made pursuant to death.

b. Social Policy Influences

In the late 1800s, economic and societal changes influenced by the Industrial Revolution and the expansion of global trade resulted in taxes burdening farmers more than wealthy industrialists. Social reformers called for changes to the taxation system. Opponents to reform claimed estate taxes would disincentivize wealth accumulation and thus harm the economy.

In 1898, a federal legacy tax was proposed to fund the Spanish-American War under a Republican-controlled House and Senate and Republican President William McKinley. In contrast to earlier estate taxes imposed to fund wars, there was great debate in the country regarding this proposal. Passed as part of the War Revenue Act of 1898, the resulting tax was a combination of an estate tax (based upon value of the

total estate and imposed upon the estate as opposed to the heir) and an inheritance tax (based upon the value received as well as the beneficiary's relationship to the decedent and imposed upon the beneficiary). Referred to as a legacy tax, the tax utilized graduated rates based upon the value of personal property received and the relationship of beneficiaries to the decedent, with exemptions for small estates and surviving spouses, and was paid by the estate. A change in 1901, also under a unified Republican government, created further exemptions influenced by societal trends and social policy, such as incentivizing gifts to charities and organizations that promoted the arts and social welfare. In 1902, the war ended, expenses decreased, and Congress subsequently repealed the tax.

With the economic, political, and social changes in the United States, calls for the imposition of taxes to fund and influence public policy initiatives continued. Only a few years after the repeal of the legacy tax, Republican President Theodore Roosevelt declared support for income and inheritance taxes as a way to redistribute wealth. The Republican-controlled Congress prevented the imposition of such taxes. In 1909, the Republican-led House Ways and Means Committee suggested reinstating the inheritance tax, but a later amendment to the bill removed the proposed inheritance tax. Conversely, Congress approved the Sixteenth Amendment, thus permitting broader federal taxation upon ratification in 1913. While income taxes were imposed shortly thereafter, no estate tax was enacted until the next major war.

The imposed tax varied in form, ranging from stamps to estate, legacy, or inheritance taxes. Unlike earlier implementations, when the federal estate tax introduced again in 1916 to fund World War I, it was not repealed. Instead, since 1916, the estate tax has remained in place as a revenue source for the government. In 1976, Congress implemented a unified system of wealth transfer taxes – namely estate, gift, and generation-skipping taxes - thus creating the modern estate tax system as we know it. The most recent change to the modern estate tax system was the "American Taxpayer Relief Act of 2012." President Trump has proposed completely repealing the estate tax, though it is unclear what the new system would be. During his campaign, he proposed a so-called mark to market tax at death in place of a traditional estate tax, but even this proposal has its uncertainties. If the current estate tax system is repealed, a future Congress could enact a new estate, gift, and/or generation-skipping tax system and thus knowledge of the history and planning required under the various systems remains important.

c. The Beginning of the Modern Estate Tax

In the 1910s, global conflicts substantially reduced global trade and tariff revenues, requiring the Democratic Congress to explore other revenue sources. One such option was an estate tax passed as part of the Revenue Act of 1916. This tax was imposed on the net estate value and paid by the estate itself rather than by the beneficiaries, making it "a true estate tax" similar to the current estate tax system. It included an exemption amount for residents and a graduated tax rate based upon estate size, both features of today's estate tax. When the United States entered World War I in 1917, the rates increased. The Senate Finance Committee justified such high

estate taxes as necessary in an emergency, wartime measure and acceptable by the federal government only as such. If the emergency was resolved, such measures would be only acceptable if imposed by the states. In 1918, the split government enacted changes to expand the assets subject to the tax were expanded while allowing charitable gifts as a deduction.

Unlike prior estate taxes, Congress did not repeal this tax following World War I. Instead, Congress has modified and revised the estate tax system. Over the years, other features we know as part of our current estate tax system were added:

i. In 1924 rates increased, and a further expansion of taxable estate assets was implemented to include revocable transfers. A credit for state estate taxes was also added. At the same time, to thwart those attempting to evade the estate tax by making lifetime gifts, Congress enacted a gift tax. Congress repealed the gift tax only two years later, and replaced it with a provision including any gifts made within two years of death in the net estate. In 1932, again under a unified Republican government, the gift tax was re-enacted, both to prevent evasion of the estate tax through the use of lifetime gifts and to provide more federal revenue during the Depression.
ii. In 1948, the concept of a marital deduction was introduced for estate and gift tax purposes. Further, the ability to split gifts was added, which allowed each spouse to claim only one half of a gift made from the married couple to a third party, thus doubling the annual gift tax exclusion amount for married couples.

d. 1976 – The Unified System – Making Wealth Transfer Taxes Great (… Again?)

Over the following decades, Congress worked to close loopholes in the transfer tax system. The most significant of the resulting changes were enacted under the Tax Reform Act of 1976, which became law under a Democrat-controlled Congress and Republican President Gerald Ford. The Act added the generation-skipping tax (GST) and unified the estate and lifetime gift taxes. The unified estate and gift tax utilized a single exclusion amount, tax base, and rate schedule and removed the gifts made in contemplation of death rule. Further changes included the carryover basis rule, special valuation and payment methods for small businesses and farms, provisions for extended payments of estate taxes, explicit disclaimer rules, and an increase to the marital deduction.

In 1980, the unified Democratic government repealed the carryover basis rule and replaced it with the step-up basis rules that had previously existed.

After much debate, the Economic Recovery Tax Act of 1981 was passed by the Democratic-majority House and Republican-majority Senate and was signed into law by Republican President Ronald Reagan. The unified estate and gift tax exclusion amount was set at $600,000 and the highest applicable rate was set at 50%. The taxable estate base was changed to include more assets but exclude half of jointly

owned property. The Act made the marital deduction unlimited and allowed the inclusion of income interests.

During the late 1980s and 1990s, Congress revisited the estate tax several times, including the following significant changes.

i. The GST rate was modified in 1986 to tax such generation-skipping transfers at the highest estate tax rate. Then, in 1987, Congress overhauled the GST system, including a surtax on estates over $10 million to recapture the tax on the exclusion amount.
ii. The Technical and Miscellaneous Revenue Act of 1988 further modified the GST as well as the estate and gift tax, though most of the changes were minor. In particular, a number of definitions applicable to GST were clarified. Further, the estate and gift tax marital deduction was amended so as to not apply to transfers to non-citizen spouses unless through a qualified domestic trust and to allow for QTIP elections.
iii. In 1997 under Democratic President William Clinton, Congress, with Republicans holding a small majority in each the House and the Senate, raised the unified estate and gift credit for the first time since 1987, revoking the 1987 phase-out. At the same time, the term "credit" was replaced with the term "applicable exclusion amount." Further, a deduction for qualified family-owned businesses was added.
iv. In 1999, gradual increases were enacted to raise the exclusion amount to $1,000,000 in 2006 and the family-owned business exclusion became a deduction. Additionally, the allocation of deductions between estate taxes and income taxes was made to be more rational under the Hubert regulations, a recommendation dating back to 1969. Though the Clinton Administration made other proposals to reduce valuation discounts and otherwise increase the estate tax, such proposals were not enacted by Congress.
v. In 2000, both chambers of Congress passed the "Death Tax Elimination Act of 2000" by large majorities, but Democratic President Clinton vetoed the bill. This Act would have reduced the highest rate incrementally through 2009; converted the unified credit to an exemption (meaning that the exemption would reduce the amount paid at the highest rather than lowest tax rate); eliminated the surtax on taxable estates over $10 million; repealed the estate, gift, and GST taxes for 2010; and replaced such taxes with a carryover basis system.

e. Wealth Transfer Taxes in the 21st Century

i. EGTRRA

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") was enacted under Republican President George W. Bush, a nearly split Senate, and a House with a small Republican majority. The Act included a scheduled phase-out of rates and increased the credit such

that the estate and generation-skipping taxes would be entirely repealed in 2010. Rather than repealing the gift tax, Congress left it in place with a $1 million exclusion and a reduced rate of 35% to discourage the transfer of highly appreciated or income-producing assets to those in lower income brackets to reduce tax liabilities. Furthermore, the Act repealed the state death tax credit, replacing it instead with a deduction for state estate taxes paid. Finally, a modified carryover basis, including exclusion amounts for heirs and an additional exclusion amount for a spouse, replaced the step-up in basis for 2010.

These provisions were to sunset in 2011, which would have restored the system to the pre-2001 law. With EGTRRA passing only after much debate, the sunset provision was understood to have been utilized under the assumption that Congress would enact an extension of the estate tax repeal long before 2011. However, while many bills were introduced and debated, Democrats and Republicans were unable to reach a compromise.

ii. TRUIRJCA

Ultimately, in December 2010, Congress passed and President Obama signed the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" to deal with the sunsetting provisions of EGTRRA and avoid the reversion of the estate tax back to the pre-2001 levels. The act provided for a top estate and gift tax rate of 35% and a unified exclusion amount of $5 million for 2010. This amount was for the first time indexed for inflation and portable between spouses. Further, the GST exclusion amount was also set to $5 million and a top rate of 0% for 2010 and 35% for 2011. The gift tax exemption was also unified with the estate tax exemption at $5 million with the same indexing for inflation. Finally, given the late-breaking nature of the Act, the Act allowed executors of 2010 estates to opt in to the modified carryover basis system which otherwise would have been in effect in 2010 and forego the traditional estate tax regime. However, all of these provisions were only implemented through the end of 2012 with yet another sunset, creating uncertainty for planners and yet another potential reversion of the estate tax rules back to the pre-2001 regime.

iii. ATRA

The 2012 election resulted in a re-elected Democratic President, Republican House (234-202), and Democratic Senate (53-45, with 2 Independents caucused with Democrats). The impending sunset, known as the fiscal cliff, created intense pressure for the government to reach a solution.

The American Taxpayer Relief Act of 2012 passed both the House and the Senate and was signed into law by President Obama on January 2, 2013.

The Act adopted the exemption regime established by TRUIRJCA, but increased the estate tax rate to 40%. It also made permanent the so-called portability provisions allowing surviving spouses to utilize the unused exemption of a pre-deceased spouse.

3. A "Uuuge" Change to Estate Planning

a. The Scuttlebutt

Since Trump's election, practitioners have been speculating and making predictions as to what might become of the "permanent" estate tax regime implemented by ATRA. The future of wealth transfer taxes, seen as a target of the Republican Party, has become a hot topic in the estate planning world once again. Commentators have been mulling over the potential changes that could be implemented, including:

i. Full repeal of wealth transfer taxes;
ii. Repeal of the estate tax (and perhaps GST tax) but maintaining the gift tax as a "backstop";
iii. Replacement of the estate tax with a capital gains tax at death;
iv. Repeal of the step up in basis;
v. Replacement of the step up in basis rules with a modified carryover basis regime (similar to 2010); and
vi. Implementation of an inheritance tax in lieu of an estate tax.

b. House and Senate Bills

Since ATRA, bills have periodically been proposed in both the House and Senate to modify or repeal in part or in whole the US Wealth Transfer Tax regime, but have gained little traction given general discord in Congress and the unlikely implementation of any such bills by President Obama. This dynamic has significantly changed with the election of President Trump and the Republican majorities in both houses of Congress. Now, modification or repeal of the estate, gift, and GST taxes are on the table and, leading up to Trump's tax reform proposal on April 26th, a number of bills have been proposed, giving some indication of the direction of the future of wealth transfer taxes in the US.

i. H.R. 451: The "Permanently Repeal the Estate Tax Act of 2017"

This bill is short, sweet, and to the point. It states simply that for "decedents dying after December 31, 2016, Chapter 11 of the Internal Revenue Code of 1986 is repealed." This bill operates to repeal the estate tax, but to leave the gift tax and generation-skipping transfer tax in place. This bill would also retain the so-called step up in basis for assets passing through a decedent's estate, as specifically noted in the bill.

ii. H.R. 30: The "Farmers Against Crippling Taxes Act" and H.R. 198: The "Death Tax Repeal Act of 2017"

These bills are similarly short and to the point, but go much further than H.R. 451 and repeal the entirety of Subtitle B of the Internal Revenue Code which includes estate, gift, and generation-skipping transfer tax. Notably, the bills also state that repeal would be effective upon enactment rather than retroactive to December 31, 2016. The bills do not mention the step up in basis, but by implication leave the step up as is.

iii. H.R. 631 and S.B. 205: The "Death Tax Repeal Act of 2017"… again

These mirroring bills in both houses of Congress have multiple co-sponsors. These bills are somewhat longer than H.R. 451 and H.R. 198. In effect, they would repeal the estate and generation-skipping transfer taxes, but retain the gift tax at a top rate of 35% and the $5 million exemption, which would continue to be indexed for inflation. They also maintain the taxation of existing QDOTs for 10 years. Finally, each of these bills is effective upon enactment. The bills do not address any changes to the step up in basis under IRC 1014.

c. 2017 Tax Reform for Economic Growth and American Jobs Plan: The Biggest Individual and Business Tax Cut in American History

On April 26th, Trump unveiled his proposal for tax reform which would be the first major overhaul of the Internal Revenue Code since 1986. However, the proposal leaves practitioners and the public alike wanting for detail. With respect to wealth transfer taxes, the sole clue provided on what might happen to wealth transfer taxes is a bullet point providing "Repeal the death tax." Notably, under the "simplification" section of the plan, a noted goal by Trump is to "Eliminate targeted tax breaks that mainly benefit the wealthiest taxpayers."

The proposal does not indicate whether repealing the death tax would include repeal of the gift and GST tax systems, whether there would be a replacement for the "death tax" such as a deemed capital gains tax on death (similar to the Canadian system), or whether the step up in basis would remain or not.

d. The devil is in the details

Notably, a key consideration in implementing any of these proposed changes to our wealth transfer tax system is how the changes will occur. While Republicans hold a majority in both houses of Congress, Republicans do not hold 60 seats in the Senate. This threshold is significant because in order to enact a law which increases the federal deficit beyond 10 years, Senate rules require a vote of 60 members to pass the measure. Otherwise, any changes must expire within 10 years of enactment. Therefore, even if any of the proposed changes to wealth transfer taxes gain support of a majority of the Senate, lacking Democratic support, Senate Republicans may have to implement the changes via budget reconciliation, which requires only a simple majority but must phase out after a decade. Therefore, the question is not just

a matter of what changes might be implemented, but how long they might last and the implications if there is another impending sunset on wealth transfer tax rules.

4. Planning in an Uncertain Environment

Estate planners are no stranger to planning for uncertainty. From 2001 – 2013, estate planning lived in a continuous period of flux between continually changing exemptions, rates, and the multiple sunsets built into the various bills governing the wealth transfer tax regime. However, a few observations are helpful in guiding planning strategies for practitioners advising clients on developing an estate plan.

First, wealth transfer taxes have been part of the U.S. tax system for the past 100 years in some form or another, so practitioners should assume there will be wealth transfer taxes with which their clients will need to contend. Second, none of the current proposals on the table eliminate the step up in basis for assets on death meaning practitioners should focus not only on the wealth transfer taxes, but the related income tax benefits of obtaining a step up in basis on assets passing through a decedent's estate. Third, wealth transfer taxes are a politically sensitive topic subject to the whims of change based on public sentiment and the philosophy of a current administration, which ultimately means that any planning undertaken should allow for as much flexibility as possible to accommodate anticipated or unanticipated changes down the road.

Keeping these considerations in mind, for most clients concerned about wealth transfer taxes and obtaining the benefits of a step up in basis, joint revocable trusts and general power of appointment trusts are two of the most powerful tools estate planners can use to cope with an ever-changing wealth transfer tax landscape and ensure maximum flexibility down the road to adjust the planning as needed to account for changes in the law.

a. Joint Revocable Trusts

A joint revocable trust is a trust established joint by a married couple to which they jointly contribute all of their assets which they would normally fund into their separate trusts under a more "traditional" his and hers revocable trust plan. Properly structured, the joint revocable trust is designed to take advantage of all of the benefits of traditional revocable trust planning while providing the added benefits of fully utilizing the Massachusetts and Federal exemptions of the first spouse to die, regardless of which spouse passes first, and achieving a step up in basis in all of the assets of the couple as opposed to a traditional plan, which would only provide a step up on the assets in the trust of the deceased spouse.

To fully understand how to structure a joint revocable trust, it is important to understand certain code provisions:

i. IRC 2041 – POWERS OF APPOINTMENT

(a) In general. The value of the gross estate shall include the value of all property—

(2) Powers created after October 21, 1942
To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released such a power of appointment by a disposition which is of such nature that if it were a transfer of property owned by the decedent, such property would be includible in the decedent's gross estate under sections 2035 to 2038, inclusive. For purposes of this paragraph (2), the power of appointment shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the exercise of the power takes effect only on the expiration of a stated period after its exercise, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised.

(b) Definitions. For purposes of subsection (a)—

(1) GENERAL POWER OF APPOINTMENT. The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that—

(A) A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

ii. IRC 2036 - TRANSFERS WITH RETAINED LIFE ESTATE

(a) GENERAL RULE.—The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

iii. IRC 2056 - BEQUESTS, ETC., TO SURVIVING SPOUSE

(b) LIMITATION IN THE CASE OF LIFE ESTATE OR OTHER TERMINABLE INTEREST. —

(7) ELECTION WITH RESPECT TO LIFE ESTATE FOR SURVIVING SPOUSE.

(A) IN GENERAL.—In the case of qualified terminable interest property—

(i) for purposes of subsection (a), such property shall be treated as passing to the surviving spouse, and

(ii) for purposes of paragraph (1)(A), no part of such property shall be treated as passing to any person other than the surviving spouse.

(B) QUALIFIED TERMINATION INTEREST PROPERTY DEFINED.— For purposes of this paragraph —

(i) IN GENERAL.— The term "qualified terminable interest property" means property—

(I) which passes from the decedent,
(II) in which the surviving spouse has a qualifying income interest for life, and

(III) to which an election under this paragraph applies.

(ii) QUALIFYING INCOME INTEREST FOR LIFE.— The surviving spouse has a qualifying income interest for life if—

(I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

(II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Subclause (II) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

(iii) Property includes interest therein. — The term "property" includes an interest in property.

(iv) Specific portion treated as separate property. — A specific portion of property shall be treated as separate property.

(v) Election. — An election under this paragraph with respect to any property shall be made by the executor on the return of tax imposed by section 2001.Such an election, once made, shall be irrevocable.

iv. IRC 2523. GIFT TO SPOUSE

(a) ALLOWANCE OF DEDUCTION.—Where a donor transfers during the calendar year by gift an interest in property to a donee who at the time of the gift is the donor's spouse, there shall be allowed as a deduction in computing taxable gifts for the calendar year an amount with respect to such interest equal to its value.

(b) LIFE ESTATE OR OTHER TERMINABLE INTEREST.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

(1) if the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee spouse (or the estate of such spouse), an interest in such property, and if by reason of such retention or transfer the donor (or his heirs or assigns) or such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse; or

(2) if the donor immediately after the transfer to the donee spouse has a power to appoint an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For purposes of this paragraph, the donor shall be considered as having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or on the failure of an event or contingency to occur.

An exercise or release at any time by the donor, either alone or in conjunction with any person, of a power to appoint an interest in property, even though not otherwise a transfer, shall, for purposes of paragraph (1), be considered as a transfer by him. Except as provided in subsection (e),

where at the time of the transfer it is impossible to ascertain the particular person or persons who may receive from the donor an interest in property so transferred by him, such interest shall, for purposes of paragraph (1), be considered as transferred to a person other than the donee spouse.

(e) LIFE ESTATE WITH POWER OF APPOINTMNET IN DONEE SPOUSE.—Where the donor transfers an interest in property, if by such transfer his spouse is entitled for life to all of the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the donee spouse to appoint the entire interest, or such specific portion (exercisable in favor of such donee spouse, or of the estate of such donee spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of such interest, or such portion, to any person other than the donee spouse—

(1) the interest, or such portion, so transferred shall, for purposes of subsection (a) be considered as transferred to the donee spouse, and

(2) no part of the interest, or such portion, so transferred shall, for purposes of subsection (b)(1), be considered as retained in the donor or transferred to any person other than the donee spouse.

This subsection shall apply only if, by such transfer, such power in the donee spouse to appoint the interest, or such portion, whether exercisable by will or during life, is exercisable by such spouse alone and in all events. For purposes of this subsection, the term "specific portion" only includes a portion determined on a fractional or percentage basis.

v. IRC 1014 – BASIS OF PROPERTY ACQUIRED FROM A DECEDENT

(a) In general. Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be—

(1) the fair market value of the property at the date of the decedent's death

(b) Property acquired from the decedent. For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(9) In the case of decedents dying after December 31, 1953, property acquired from the decedent by reason of death, form of

ownership, or other conditions (including property acquired through the exercise or non-exercise of a power of appointment), if by reason thereof the property is required to be included in determining the value of the decedent's gross estate under chapter 11 of subtitle B or under the Internal Revenue Code of 1939.

(e) Appreciated property acquired by decedent by gift within 1 year of death

(1) In general

In the case of a decedent dying after December 31, 1981, if—

(A) appreciated property was acquired by the decedent by gift during the 1-year period ending on the date of the decedent's death, and

(B) such property is acquired from the decedent by (or passes from the decedent to) the donor of such property (or the spouse of such donor), the basis of such property in the hands of such donor (or spouse) shall be the adjusted basis of such property in the hands of the decedent immediately before the death of the decedent.

(2) Definitions

For purposes of paragraph (1)—

(A) Appreciated property

The term "appreciated property" means any property if the fair market value of such property on the day it was transferred to the decedent by gift exceeds its adjusted basis.

(B) Treatment of certain property sold by estate

In the case of any appreciated property described in subparagraph (A) of paragraph (1) sold by the estate of the decedent or by a trust of which the decedent was the grantor, rules similar to the rules of paragraph (1) shall apply to the extent the donor of such property (or the spouse of such donor) is entitled to the proceeds from such sale.

Applying these code sections, the IRS in PLRs 200101021 and 200210051 analyzed the tax treatment of a joint revocable trust and held that:

i. Contribution of assets to the trust is not a completed gift;
ii. Distributions from the trust would qualify for the gift tax marital deduction;
iii. All trust assets are included in the estate of the first spouse to die
    a. Deceased spouse's assets includible under IRC 2038;
    b. Surviving spouse's assets are includible under IRC 2041;
iv. Grant of general power of appointment by surviving donor to deceased donor is a gift that qualifies for the gift tax marital deduction;
v. Funding of the trust shares with the assets of the surviving donor and distributions from the remainder share to persons other than the surviving donor do not constitute gifts by the surviving donor; and
vi. Assets in the remainder share are not includible in the surviving donor's estate

Question: What about 1014(e)?

Both rulings cite IRC 1014(e) as part of the analysis for considering the ruling requests, but neither ruling actually states that 1014(e) does not apply to prevent a step up in basis. However, it is implied in both rulings that the assets do not pass back to the surviving spouse and therefore 1014(e) would not prevent the step up in basis.

HYPOTHETICAL:

Consider the case of a married couple with combined assets of $3,000,000, with $1,500,000 in the husband's IRA and $1,500,000 consisting of other jointly owned assets. Assume the couple lives in Massachusetts where the $1,000,000 Massachusetts exemption is in place and the current federal estate tax rules are applicable.

In the typical estate plan, both spouses would implement an estate plan centered around a pourover Wills and two revocable trusts. The joint assets would likely be transferred to the wife's revocable trust. The IRA, which cannot be transferred without income tax consequences, would be made payable to the surviving spouse with the husband's remainder share named as a contingent beneficiary in the event the surviving spouse disclaims the asset.

Under this plan if the husband were to die first, his sole asset would be his IRA payable to the wife. If she did not disclaim, none of his exemption would be used and, in Massachusetts, it would be wasted since Massachusetts does not allow for portability. Alternatively, wife could disclaim $1,000,000 of the IRA, forcing it into the remainder share. This disclaimer would utilize his exemption, but wife would have to forego the benefits of rolling husband's IRA into her own which would have allowed her to delay distributions until she attains age 70½ and given her the ability

to take advantage of stretching out the payments using her own minimum distribution computations. In either event, the assets in the wife's trust would have carryover basis until the wife's death.

Contrast this planning outcome with a joint revocable trust. Instead of two revocable trusts, the couple would implement a joint revocable trust which provides:

i. Husband and Wife are the Donors of the Trust and the Trustees for so long as they are both living;
ii. During life, the trust is revocable as to the assets each spouse contributed to the trust;
iii. Upon the death of the first spouse, that deceased spouse is granted a general power of appointment over the assets the surviving spouse contributed to the trust;
iv. If not exercised by the deceased spouse, the assets contributed by the surviving spouse, along with the assets contributed by the deceased spouse are funded into three shares (in Massachusetts):
    (a) General Marital Share - income and principal to spouse upon request;
    (b) Special Marital Share - income to spouse for life. Principal payable to spouse to maintain health and support;
    (c) Remainder Share - income to spouse for life. Principal to spouse and descendants for health, education, maintenance and support;
v. Surviving Spouse serves as sole Trustee upon death of the first spouse
    (a) PLANNING NOTE: Added flexibility can be provided by including provisions in the special marital share and remainder share which provide that an independent trustee can make distributions of principal to the spouse in the independent trustee's discretion

In the joint trust plan, the IRA would remain payable to the surviving spouse with the joint trust as the contingent beneficiary. The $1,500,000 in jointly owned assets would be transferred directly to the joint trust. In the event the husband dies first, his estate would be worth $3,000,000 with the $1,500,000 IRA flowing over to the surviving spouse eligible for the marital deduction and $1,500,000 allocated to the husband's by-pass trust. The surviving spouse would then be able to delay distributions from the IRA until she attains age 70½ and then take advantage of the new uniform life table stretching out the IRA benefits. The $1,500,000 of non-IRA assets would fully utilize the husband's Massachusetts exemption and fund the remainder share, with the balance of the assets ($500,000) funding the special marital share. Both the assets funding the remainder share and the special marital share would have a full step up in basis.

b. General Power of Appointment Trusts

For cases where the total assets of the estate exceed the federal estate tax threshold, a joint trust may not be appropriate (ie. discount planning, maximizing use of federal

exemption, etc.). In these cases, consider using a traditional two revocable trust plan, but granting general powers of appointment in each trust to the spouse to the extent of remaining estate tax exemption unused by the spouse in the event of the spouse's death.

The IRS considered the tax consequences of such arrangements in PLRs 200403094 and 200604028.

FACTS

In each of these rulings, the taxpayer proposed to establish a single revocable trust and fund it with his own assets, but giving his wife a general power of appointment over a portion of the assets in the husband's trust equal to the value of the wife's remaining applicable exclusion amount, less the value of the wife's taxable estate determined as if she did not possess this power.

Upon wife's death (who has little or no assets) the husband is required to pay over such amount from his trust to the wife's estate whereupon such assets will be held in a traditional by-pass share established in the wife's trust, as though the wife had established the by-pass share for the benefit of her husband.

The husband was the sole trustee of the wife's by-pass trust (which was funded with the husband's assets taken out of his revocable trust).

The trust provides that the trustee will pay to the husband and to the husband's descendants any amount of income and principal of the wife's by-pass trust that the trustees deem necessary and advisable for the health, education, support, and maintenance of the husband and his descendants.

If the trust holds wife's residence, during his life, husband will have the exclusive use of that residence and the wife's family trust will pay all costs associated with that use.

Husband also will have a testamentary limited power of appointment to appoint the assets of the wife's by-pass trust among his then living descendants.

Any assets not so appointed, will be distributed to the wife's then living descendants by right of representation.

RULINGS

Ruling 1: If wife predeceases husband, the value of trust assets over which wife holds a general power of appointment will be included in wife's gross estate.

Ruling 2: If wife exercises that power of appointment, husband is treated as relinquishing his dominion and control over the property, subject to that power of appointment. Accordingly, on the death of wife, if wife exercises the power of

appointment granted her, husband will have made a completed gift to her under Section 2501 and will be eligible for the federal gift tax marital deduction under Section 2523.

Ruling 3: Any assets that originated in husband's revocable trust and that pass to the wife's by-pass trust will not constitute a gift from husband to the other beneficiaries of the wife's trust since wife, at her death, will be treated as the owner of the trust assets she appoints.

Ruling 4: None of the assets in the wife's by-pass trust will be includible in the husband's estate, since in his role as either a beneficiary or a trustee, husband will not have a general power of appointment under Section 2041, because distributions of income and principal from wife's family trust are subject to an ascertainable standard. Also, any interest husband may have under wife's by-pass trust in a residence in which he may have had an ownership interest would not cause that residence to be includible in his gross estate under Section 2036. As a result, none of the assets in the wife's by-pass trust will be includible in the husband's gross estate.

Question: Does the spouse actually have to exercise the power to achieve the same result?

In PLR 200403094 and in PLR 200604028, the facts showed that the wife intended to actually exercise the general power of appointment. In PLR 200101021, the power of appointment was not expressly exercised and the assets passed in default of appointment to a by-pass trust for the benefit of the donor. The IRS ruled that the gift qualified for the gift tax marital deduction.

Treasury Regulations 25.2523(e)-1(G)(2) provides that the actual exercise of a testamentary general power of appointment is not required in order to qualify for the gift tax marital deduction. The Regulations provide that an income interest coupled with a general power of appointment will qualify for the gift tax marital deduction even though the donee spouse does not exercise the power and takers in default designated by the donor spouse ultimately receive the property.

5. Conclusion

Estate planning may be heading towards another state of flux, depending on what route the Trump administration and the Republican-controlled Congress take towards modifying or repealing wealth transfer taxes - but this uncertainty is nothing new for practitioners. Practitioners should consider not only what proposals are on the table, but how they might be implemented and the time frame such changes may last. Ultimately, practitioners need to plan for clients based both on current law and potential changes to the wealth transfer tax regime in the short term, but also with an eye towards long term considerations. Plans should be as dynamic and flexible as possible to allow clients to achieve the best tax results possible from their estate plans both in today's environment and down the road.

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TODD E. LUTSKY joined Cushing and Dolan, P.C. in 1995 and his practice includes all aspects of estate planning from basic to sophisticated techniques, asset protection planning, trust planning, elder law, and all aspects of Medicaid application preparation and eligibility matters. He is also a member of the National Academy of Elder Law Attorneys and the Boston Estate Planning Council, and is co-founder of the Boston Chapter of the National Aging in Place Council. He was also named Five Star Wealth Manager in 2015 and 2016. Todd was recently appointed lecturer in law at the Boston University Law School Graduate Tax Program.

Todd provided his expertise from 1998-2013 as the Co-Host on a nationally syndicated live call-in radio talk show entitled Money Matters in which he answered questions and provided information on all aspects of estate and asset protection planning, trust planning, tax issues, elder law, Medicaid application preparation and elder law planning, and eligibility matters. In 2013, Attorney Lutsky was given the opportunity to host his own radio show called, The Legal Exchange with Todd Lutsky, a talk show that allows Todd a format to provide a more in-depth discussion on all the estate and asset protection planning, and elder law.

In January 2015, Todd was asked to do another radio show called "The Real Life Stories of The Legal Exchange." This is a show where he will explain situations that he has encountered during his career and provided estate and elder law planning answers to help others avoid the same problems and/or traps for the unwary. The goal is to educate Americans one story at a time.

Mr. Lutsky is a regular speaker for Massachusetts Continuing Legal Education, the Foundation for Continuing Education, Massachusetts Association of Accountants, the Mass Society of Enrolled Agents, The Massachusetts Chapter of National Academy of Elder Law attorneys, and several other organization and associations. Finally Todd was recently appointed lecturer in Law at Boston University Law School Graduate Tax Program.

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Cushing & Dolan, P.C.
2017 Spring Seminar

Tuesday, May 2, 2017

PART III:

Medicaid Planning Update - How to Design the Perfect Income Only Irrevocable Trust!

Presented by:
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I. Designing the perfect Income only Irrevocable Trust including a discussion on:

a) Obtaining a step up in basis
b) Preserving grantor trust status
c) Who can serve as trustee
d) Retain powers to control final disposition
e) Reservation of life estate or not to reserve one versus the right to use and occupy language in the trust

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f) Incomplete gifts
g) Trustee's powers to make distributions for benefit on donor's descendants
h) Proposed changes to add "used" to trust countably rules
i) Transfers subject to a 5 year look back period
j) May not be appropriate for cases with large qualified plan assets
k) Consider long term care insurance
l) Legal challenges

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II. Last Minute Planning with Annuities and/or Pooled Trusts

a) Community spouse annuity in the case of a married couple
b) Using an annuity in the case of a single person
c) Using a pooled trust and proposed changes to regulations
d) Proposed regulation change to make date transfer penalty period begins is equal to the date the deed is recorded

4

MEDICAID TRUSTS

Designing the Perfect Income-Only Irrevocable Trust

Careful drafting and funding of trusts can help clients qualify for Medicaid benefits and continue to make use of trust assets.

Author: LEO J. CUSHING and TODD E. LUTSKY

LEO J. CUSHING, CPA, LL.M, and TODD E. LUTSKY, LL.M, are attorneys at Cushing & Dolan, P.C., in Waltham, Massachusetts.

The biggest question on the minds of elder law attorneys these days is whether to use Medicaid irrevocable income-only trusts as a planning tool. It is no secret that across the country these trusts are being challenged by the states more than ever. That being said, a recent series of cases and developments acknowledge that these type of trusts are an acceptable planning tool to protect assets from the costs of long-term care, provided however; that they are carefully drafted so as not to violate the federal or state laws governing these trusts. The balance of this article explains the important paragraphs to use as well as the paragraphs to avoid when drafting these trusts, along with income, gift, and estate tax "do's and don'ts" when operating them during the donor's life.

References to state developments in this article frequently cite Massachusetts, as that is the state in which the authors practice. Readers should consider how the laws of their jurisdictions may differ when implementing the planning ideas.

Important language for irrevocable trusts

Surviving spouse, Mrs. Public, established an income-only irrevocable Medicaid trust in 2007, naming two of her children as trustees. (Very similar terms would apply for a married couple, with the only difference being that income would be payable to both the donor and the donor's spouse, and a marital and by-pass share might be built in on the death of the first spouse in order to reduce or eliminate, if possible, state and federal estate tax.) The trust provides as follows:

(1) For so long as Mrs. Public is alive, income from the trust is payable to her.

(2) Under no circumstances is the trustee permitted to pay to or use principal for Mrs. Public's benefit.

(3) The trustee, in its discretion, may pay principal to or for the benefit of the class consisting of Mrs. Public's children of all generations.

(4) Mrs. Public reserved, in the trust instrument, the right to appoint principal or income to or for the benefit of charities of her choosing during her life. This is known as a limited power of appointment and is what makes the trust a grantor trust for income tax purposes.

(5) Upon Mrs. Public's death, the property in the trust will be paid over to those persons selected from the class consisting of her issue and nongovernmental charities, in equal or unequal amounts, as designated in a Last Will and Testament referring to this power executed after the execution of the trust. This is known as a testamentary power of appointment.

(6) In the event the power is not exercised, the property shall be sold and the proceeds added to the balance of the trust assets and all trust assets to be divided into as many equal shares as there are children then living or children then deceased leaving children then living. In the case of a share allocated to a child, such share will be paid out and distributed free of all trusts. In the event a child died, that child's share would be held in trust for that child's children rather than that child's spouse and such share will be held in trust for the benefit of those grandchildren until no such grandchild is under 30 years of age.

Planning note. Assets may be left to family members in many different ways. The method selected is generally based on the particular family situation. For example, a continuing spendthrift discretionary trust can divorce-proof the trust and provide generation-skipping tax benefits.[1]

Federal regulations regarding trusts

These trust cases generally revolve around the interpretation of the language of various trust provisions involved and the applicable regulations. Medicaid is a federal law implemented by the states. Below are the federal regulations (after 1993) governing the treatment of trusts, which may vary slightly when adopted by the various states but cannot be adopted in a way that is more restrictive than these federal regulations.

Federal law at 42 USC §1396p42 USC §1396p provides:

(d) Treatment of Trust amounts

(1) For purposes of determining an individual's eligibility for, or amount of, benefits under a State plan under this subchapter, subject to paragraph (4), the rules specified in paragraph (3) shall apply to a Trust established by such individual.

(2)(A) For purposes of this subsection, an individual shall be considered to have established a Trust if assets of the individual were used to form all or part of the corpus of the trust and if any of the following individuals established such trust other than by will:

(i) The individual.

(ii) The individual's spouse.

(iii) A person, including a court or administrative body, with legal authority to act in place of or on behalf of the individual or the individual's spouse.

(iv) A person, including any court or administrative body, acting at the direction or upon the request of the individual or the individual's spouse.

(B) In the case of a trust the corpus of which includes assets of an individual (as determined under subparagraph (A)) and assets of any other person or persons, the provisions of this subsection shall apply to the portion of the trust attributable to the assets of the individual.

(C) Subject to paragraph (4), this subsection shall apply without regard to—

(i) the purposes for which a trust is established,

(ii) whether the trustees have or exercise any discretion under the trust,

(iii) any restrictions on when or whether distributions may be made from the trust, or

(iv) any restrictions on the use of distributions from the trust.

(3) (A) In the case of a revocable trust—

(i) the corpus of the trust shall be considered resources available to the individual,

(ii) payments from the trust to or for the benefit of the individual shall be considered income of the individual, and

(iii) any other payments from the trust shall be considered assets disposed of by the individual for purposes of subsection (c) of this section.

(B) In the case of an irrevocable trust

(i) if there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual, and payments from the portion of the corpus or income—

(I) to or for the benefit of the individual, shall be considered income of the individual, and

(II) for any other purpose, shall be considered a transfer of assets by the individual subject to subsection (c) of this section; and

(ii) any portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual for purposes of subsection (c) of this section, and the value of the trust shall be determined for purposes of such subsection by including the amount of any payments made from such portion of the trust after such date. [Emphasis added.]

Problematic trust provisions

The current status of problematic trust provisions is discussed below.

Purposes clauses. These are paragraphs that indicate that the trust is designed for a reason, such as to provide for the donor to have as complete a life as possible and to ensure that the donor's assets in the trust are to be used to keep the donor in the community as long as possible. This type of language could cause the assets in the trust to be countable for Medicaid purposes.

The standard to determine if an asset is countable for Medicaid purposes is if there are *any circumstances*, regardless of how remote, that principal of the trust can be paid to the donor then it must be paid and will be considered countable. Clauses like this one make it appear that principal is available and thus may result in a denial for Medicaid benefits. While this clause alone may not cause the trust assets to be countable, it nevertheless should not be a part of a Medicaid irrevocable trust.[2]

Termination clauses. These are clauses placed in the trust that generally allow the trustee under certain circumstances to terminate the trust and distribute the assets out to the beneficiaries. The problems with this type of language is that if all the trust assets can be distributed to the beneficiaries and there is no distinction made between the income and principal beneficiaries, and the donor is generally an income beneficiary, the court will assume that the principal could be distributed to the donor of the trust, thus making the assets countable for Medicaid purposes. Again, if the principal can be paid to the donor under *any circumstance,* then it must be paid and will make the assets of the trust countable.[3]

Trigger language. This language was popular before 1993, but these trusts still exist and were not grandfathered by the 1993 Medicaid legislation. This language generally states that during any period that the donor of the trust is not eligible for Medicaid benefits, the trustee in its discretion can distribute principal to the donor for his or her care or for health and medical expenses including nursing home care, etc. Even though the trust may have stated that the trustee cannot distribute principal to the donor in any other paragraph, the state will deny the donor Medicaid benefits because by not being eligible, the principal of the trust can be paid out to that individual.

This is certainly language that should not be placed in a Medicaid irrevocable trust if the donor wants to add certainty to the protection of his or her assets. More troubling are trusts drafted under prior law

that included triggering language, as they were not grandfathered once the updated law was passed.[4]

Silence as to the distribution of principal. Sometimes a trust is drafted to state that income can be distributed to the donor during the donor's lifetime, but the trust fails to mention whether principal can be distributed out to the donor. This is likely to cause the state to take a closer look at the trust and then end up denying Medicaid benefits.

In a recent fair hearing on this very matter, the state was successful in denying the applicant Medicaid benefits, which resulted in the trust assets being countable and at risk for nursing home costs. The state indicated that under the Uniform Trust Code, and coupled with the other broad trustee powers that the trust contained, if the trust does not prohibit the trustee from taking an action then that action can be taken. In this case, the trust did not specifically prohibit the distribution of principal, so it was determined that principal could be distributed.[5]

The prudent form of trust drafting must include a paragraph that specifically prohibits the distribution of principal to the donor or the donor's spouse under any circumstances. In fact, this may be the single most important paragraph in the trust.

Trustee's power to lend money to a beneficiary. This type of paragraph can usually be found in the trustee power section of the trust. It might generally state that the trustee has the power to lend money to the beneficiary when and if reasonably necessary and with or without interest or security. The real problem with this is that the donor of the trust is likely an income beneficiary and because the power granted to the trustee allows him or her to lend money to any beneficiary, the state will determine that there is a circumstance in which principal can be distributed to the donor. Therefore, the trust assets will be countable and at risk for nursing home costs.

It is okay for the trustee to have the power to lend money but just not to the donor. It would be prudent to make sure an irrevocable income-only trust has a paragraph that specifically prohibits the trustee from lending money to the donor or creator of the trust.[6]

Right to redefine principal as income in a reasonable manner. The Uniform Principal and Income Act (UPIA) was designed to allow the trustee to allocate principal from investments to income so as not to limit investing options that may harm the income beneficiaries or vice versa. This way the trustee would not be forced to invest in only income-producing assets to help the income beneficiary while potentially hurting the principal or remainder beneficiaries and, again, vice versa. The state has successfully persuaded hearing officers and Superior Court judges that this power permitted a distribution of principal to the donor.

The solution to this problem would be to put in the trustee power section of the trust a paragraph that states, notwithstanding the Massachusetts Uniform Principal and Income Act, the trustee shall have no power to allocate principal to income. Fortunately, this may not be necessary, because of *Heyn* v.

Director of Office of Medicaid.[7] In *Heyn*, the court held that the power to allocate between income and principal did not cause the assets to be countable.[8]

Right to use and occupy real estate. In many of these trusts, the donor is given the right to use and occupy the home during the donor's life. The state has argued that this power makes the home or other real estate "available" for the donor and thus a countable asset and at risk for the costs of nursing home care. The rules governing these trusts indicate, however, that only trust assets that are payable to the donor can be countable or at risk for the nursing home costs. The state is challenging this type of language in trusts and so the solution is to simply make sure the trust does not have any such language.

In *Doherty*, the applicant did not retain a life estate but had the right to use and occupy by the house by the terms of the trust. This was one of the reasons the trust asset—i.e., the house—was countable.[9] In Fair Hearing No. 1200356, the hearing officer agreed with the authors' argument that the right to reside under the trust terms was akin to a life estate, and such a provision did not make the asset countable.

Right of substitution. This is generally a power that is put in that allows the donor the right to withdraw all of the trust assets as long as they are replaced with assets of the same value. This is a power that is used to make the trust a grantor trust for income tax purposes.[10] This is what would allow all of the trust income and capital gains to be reported on the donor's personal income tax return so that he or she continues to pay the income tax at the donor's lower rates just like before the trust was established. However, the state will interpret this to mean that the assets of the trust can be paid out to the donor, thus considered countable assets.

The solution to this problem is simply not to use this power in the trust document. The same favorable income tax benefits can be achieved by using a limited power of appointment, which allows the donor to appoint the income and principal to charities during his or her life, as mentioned above.[11]

Right to pay the donor's estate tax, estate administration costs, and costs associated with last illness. In these cases, the trustee granted the right to pay for any estate taxes due following the donor's death or all costs associated with his or her last illness or as needed to close out the estate. The problem with this power is that these expenses are generally large and would likely cause the trustee to be using principal of the trust for the benefit of the donor. Any time principal can be used for the benefit of the donor makes the trust assets countable.

Furthermore, there are cases that state the cost of the nursing home was a cost associated with the donor's last illness. This allows the state's estate recovery unit to force the access of trust principal to pay the bill. Thus, even if qualified for Medicaid benefits, the trust assets would be at risk for estate recovery purpose. This type of paragraph should not be a part of the trust.[12]

Compensation of trustees. In cases where the donor of the trust is also the trustee, MassHealth may argue that the power of the trustee to compensate himself or herself permits the distribution of principal to the donor. Of course, this analysis ignores the fiduciary principles of a trustee, as recounted in *Heyn* and *Doherty*. However, in Fair Hearing No. 16018677 and Fair Hearing No. 1509433, the fair hearing officer determined that the payment of trustee compensation to the donor, who was serving as trustee, was not a distribution of principal. Thus, it did not make a trust asset countable in a MassHealth eligibility determination. Nevertheless, best practice is to appoint a person other than the donor as trustee.[13]

Limited powers of appointment. Donors may reserve a limited power of appointment to the donor to appoint under the trust. MassHealth has argued that this limited power causes the assets to be countable, as the donor could appoint the assets to the beneficiary, who in turn could return the assets to the donor. The *Heyn* court rejected the analysis, as the assets of family members (other than the spouse) are not considered when making eligibility determinations.[14]

Pooled trusts as charities. MassHealth sometimes argues that the power to appoint to a charity runs afoul of the any circumstances test. Per MassHealth's argument, such a provision allows the donor to appoint to a pooled trust, which is a type of trust managed by a nonprofit organization that allows for certain payments back to the donor of the pooled trust. After the donor's death, the pooled trust must pay back the state, then between 10% and 20% goes to the sponsoring charity, and finally the balance is distributed to the family. This argument fails because the pooled trust itself is not a charity, and the trust does not permit appointment to a noncharitable entity.

In Fair Hearing No. 1511164, the fair hearing officer determined that because the definition of a limited power of appointment prohibits the appointment of assets to himself or herself, then the trustee could not appoint to a pooled trust because the pooled trust benefits the powerholder (i.e., the applicant). Therefore, the state's argument to appoint to a pooled trust fails, and the assets in the irrevocable trust were deemed noncountable in the Medicaid eligibility determination. In Fair Hearing No. 1604346, the fair hearing officer also indicated that this limited power of appointment to a pooled trust did not cause the assets in the trust to be countable in a Medicaid eligibility determination.

Using these trusts

By using the drafting tips discussed above, attorneys can better protect their clients' interests when creating Medicaid irrevocable income-only trusts. To which clients should these trusts be recommended, and how do these irrevocable income-only trusts operate? Those and other practical issues are discussed, in question-and-answer format, below.

Question. Who should consider using these Medicaid irrevocable trusts?

Answer. While no hard-and-fast rule restricts who can use these trusts, they are generally recommended to folks who are age 60 or older. In addition, these irrevocable trusts should be

considered if one of the objectives in the estate and elder law planning world is to protect assets from the cost of long-term care. In the event this type of asset protection planning is not important to the client, then a revocable trust would be the recommended vehicle for estate planning needs. Finally, clients who are under age 60 but have a diagnosed mobility-related illness should, of course, consider the use of these irrevocable trusts as well.

Question. Who can be the donor of these irrevocable trusts and what does that mean?

Answer. The donor is referred to as the individual who creates the trust. The donor may also retain certain powers over the trust—most importantly, the power to remove and replace a trustee at any time for any reason, provided, however, that the replacement trustee can never be the donor of the trust. This retained power by the donor allows the donor to retain a significant degree of control over the operation of the trust, even though the donor does not serve as trustee. In addition, the donor will also be an income beneficiary of the trust.

Question. Who can be the trustee of these irrevocable trusts?

Answer. Often, the donor would like to serve as trustee of the trust, thereby significantly increasing the donor's control over the operation of the trust assets during the donor's life. There is support for this position in Massachusetts; in *Ledger* v. *Department of Medical Assistance*,[15] the court indicated that, while this may appear to be an unappetizing maneuver, it nonetheless fails to contravene any rule or regulation. However, there has since been another case known as the *Doherty*[16] case in which the appellate court in Massachusetts indicated that the irrevocable trust was not drafted properly and provided too much control to the donor, thus causing the assets of the trust to be at risk. Therefore, the donor should not serve as trustee, and the trust itself should prohibit the donor from serving as trustee.

Question. Do these trusts avoid the costs associated with the probate process?

Answer. An individual who passes away and owned assets in his or her own name, without a designated beneficiary, will subject all of those assets to the costs associated with the probate process. Establishing this irrevocable trust and, most importantly, funding the trust with assets, enables the assets that have been retitled to the name of the irrevocable trust to avoid the costs associated with the probate process.

Bear in mind that individuals who have just a will need to file that one document with the probate court. If this is all the planning that was done, there is a good chance of not even avoiding probate. Finally, a will by itself will not help an individual reduce estate tax liability.

Question. Do these irrevocable trusts protect assets from the costs of long-term care and how long does it take?

Answer. Once assets have been transferred to these properly drafted Medicaid irrevocable trusts, the assets will be protected from the costs of long-term care after the expiration of five years from the date of transfer. This is known as a five-year lookback period for Medicaid eligibility purposes. This means that, from the date in which an individual would apply for Medicaid benefits, the state is entitled to look back at all of his or her prior transactions, bank accounts, investment accounts, etc., for the previous five years in order to see if there were any disqualifying transfers made during that period which would in fact prevent the individual from being eligible for Medicaid benefits.

A disqualifying transfer is when a formerly available asset is transferred for less than fair market value to a place where it is no longer available for the nursing home. This same five-year waiting period applies even if the assets are just given to children and not to a trust. Once the donor has successfully made it beyond five years from the date of transfer to the trust, the state would then no longer be able to see such a transfer and, therefore, it would be protected from the costs of long-term care.

Potential legislative change. This five-year lookback period is under review, and the federal government is constantly exploring the idea of expanding it to be a ten-year lookback period.

Question. Which type of assets should a person retitle or transfer into one of these irrevocable Medicaid trusts?

Answer. First and foremost, IRA assets or any other qualified plan asset or retirement type asset, such as a 401(k) plan or a 403(b), should not and, in fact, cannot be transferred into these irrevocable trusts during life. In order to transfer one of these qualified plan assets into the trust, the donor would first need to withdraw the money from the qualified plan, thereby subjecting it to ordinary income tax liability and transferring only the amount net of taxes to the trust. Generally, this makes funding an irrevocable trust with such assets cost-prohibitive.

The donor should use assets from qualified plans for living expenses before looking to the trust assets for that purpose because the retirement plan assets would be outside the trust and, therefore, at risk for the costs associated with long-term care.

A common asset that folks like to transfer to the trust would be their primary residence. It is also possible to transfer rental property or vacation property to these irrevocable trusts in order to protect them from the costs of long-term care.

Finally, people also wish to transfer their nonqualified investment portfolios or a portion of their investment portfolios to these irrevocable trusts in order to protect them from the costs of long-term care. All of those types of assets can, in fact, be transferred to the irrevocable trust without any adverse income or gift tax consequences.

Question. Can the donor continue to live in his or her home after it has been transferred to one of these Medicaid irrevocable trusts?

Answer. Yes, and no special language is needed in the trust stating that the donor is permitted to live there the rest of his or her life or to use and occupy the property. To ensure the donor has this right, consider having the donor retain a legal life estate in the deed transferring the property to the trust.[17] This will give the donor the right to live there, among other things, for the rest of his or her life. If the trustee tried to sell the home, he or she would now need the donor's signature. Plus, the donor may retain the right to remove the trustee. The donor is in control of the house.

Question. Can the home be sold after it has been transferred to one of these Medicaid irrevocable trusts and, if so, how does it work?

Answer. Yes, the home can be sold after it has been transferred to the irrevocable trust. Generally, the donor simply tells the trustee that the house is to be placed on the market and sold. The trustee of the irrevocable trust would sign the purchase-and-sale agreement in order to complete the transaction. Selling the property from the irrevocable trust in no way complicates the transaction nor adversely affects the buyer. Upon completion of the transaction, the buyer would cut a check made payable to the trustee of the irrevocable trust who then would, in turn, deposit the check into a bank account that is established in the name of the irrevocable trust.

The donor should not receive the money personally, but instead the money should be transferred directly into the irrevocable trust bank account so as not to restart the five-year waiting period. Finally, the house can be sold any time after it is transferred to the trust, even if it is during the initial five-year period from the date of transfer.

Question. Does the sale of a home from the irrevocable trust re-set the Medicaid five-year lookback period?

Answer. The five-year lookback period is unaffected and, in fact, not reset by the selling of a home from the irrevocable trust, because nothing new was placed into the trust. The five-year lookback period starts to run on the day an asset was transferred from an individual's own name into the irrevocable trust and not the day the trust sells the property.

For example, if the donor establishes an irrevocable trust and transfers the property into the trust on 1/1/2011, and then, on 1/1/2013, the trustee of the trust sells the property and in exchange the trust receives the proceeds, which are promptly deposited into the irrevocable trust bank account, that transaction will have no impact on the initial five-year waiting period that began on 1/1/2011, when the home was transferred to the irrevocable trust.

In other words, the proceeds from the sale of the home, which are now deposited in the trust, will be protected from the cost of long-term care in three more years, which represents the balance of the number of years remaining from the initial transfer of the home to the trust on 1/1/2011. Again, since nothing new was placed into the trust, there is no new five-year waiting period created. In this case,

the trustee simply reinvested the assets that were already inside the trust from real estate to cash or any other investment of the donor's choosing.

Question. Can the trustee of the trust use the proceeds from the sale of a previous home to purchase a new home inside the trust?

Answer. Once the proceeds from the sale of the home are received by the irrevocable trust and are deposited into the trust bank account, the trustee may invest those assets in any manner the trustee deems fit. In other words, the trustee may simply write a check to the seller of a home that the donor is interested in purchasing, and the seller will prepare a deed transferring the property to the trustee of the irrevocable trust. Once again, this transaction of purchasing the home inside the irrevocable trust does not reset the five-year waiting period.

As a practical matter, when one spouse passes away, it is not uncommon for a surviving spouse to downsize and sell the old primary residence and convert it to a condominium or some other downsized home. This transaction is completely permissible within the terms of the trust and again would not reset the five-year waiting period for Medicaid eligibility purposes.

Question. Does the donor need the permission or his or her children (as trust beneficiaries) in order to buy or sell real estate after the home has been transferred to the Medicaid irrevocable trust?

Answer. No. The donor of the trust can simply instruct the trustee to place the home on the market for sale or to purchase a new home following the sale of the previous home. In the event the trustee does not comply, the donor of the trust has retained the ability to remove and replace the trustee at any time and would thereby simply remove the trustee and put in a trustee who is willing to complete the requested transaction. Therefore, the donor does not technically need the children's permission to complete the purchase or sale of a new home after it has been transferred to the irrevocable trust.

Question. Will the donor still receive the capital gains tax exclusion upon the sale of his or her primary residence after it has been placed into an irrevocable Medicaid trust?

Answer. Yes. The IRC Section 121 capital gains tax exclusion enables married people to shelter the first $500,000 of capital gains on the sale of their primary residence (the first $250,000 of capital gains for single individuals). The rule simply states that the donors must have owned and used the property as his or her primary residence for two of the last five years in order to take advantage of this capital gains tax exclusion upon the sale of the property. Because the trust is designed as a grantor trust for income tax purposes, the individuals transferring the property to the trust will not lose their ability to take advantage of this capital gains exclusion once the property is sold from the trust.

The term “grantor trust” means that the donors, or creators of the trust, are considered the owner of the trust for all income tax purposes and, therefore, will be eligible to maintain their capital gains tax exclusion on the sale of the property from the trust. The trust is a grantor trust because the donor has retained the ability to direct where the principal or income of the trust can go during the donor's

lifetime. In accordance with Section 674(a), this retained power is what makes the trust a grantor trust for income tax purposes, thereby preserving the capital gains tax exclusion.

Question. Can a donor transfer rental property into one of these Medicaid irrevocable trusts and, if so, what are the tax and operating implications?

Answer. Rental property can be transferred to these irrevocable trusts without adverse tax implications of doing so. Remember, like the primary residence, this rental property can be sold and the proceeds can in fact be used to purchase another piece of property at any time during or after the five-year lookback period. There would also be no adverse income tax consequences associated with any such sale. In other words, the donor would continue to pay all of the same capital gains taxes associated with the sale of rental property out of the trust as the donor would have if he or she had sold the property while it was in his or her own name, because (as mentioned above) the trust is a grantor trust.

In addition, the donor would retain the ability to pay the bills associated with the rental property, make decisions regarding rental increases, make decisions regarding removal of existing tenants, and continue to collect and use the rent as usual. Remember, these were all decisions that were made by the donor prior to transferring the property to the trust.

Question. After rental property has been transferred to a Medicaid irrevocable trust, how is the rental income generally handled, and who receives it?

Answer. These Medicaid irrevocable trusts are designed as income-only trusts, which means that the trustee is obligated to pay out the income earned by the trust to the donor. Rent, of course, is income. In this regard, the tenant would write a check for the rent and make it payable to the trustee of the irrevocable trust. The trustee of the irrevocable trust must have established a checking account in the name of the irrevocable trust under its own tax identification number in order to deposit this rent check into the trust checking account. The rent check represents trust rental income for which the trustee is then obligated to write a check out of the trust checking account payable to the donor of the trust, who in turn will deposit that check into his or her own personal checking account.

The donor can also set the trust account up in a way that will automatically transfer the rental deposits to the donor's personal checking account to be used as desired. In that situation, the trustee does not need to be involved in these transactions.

In other words, the rental income will end up in the donor's personal checking account through this two-step approach instead of directly, which is where the rental income used to go prior to the rental property being transferred to the irrevocable trust. The donor is then free to spend that rental income on anything he or she desires, just like before the establishment of the trust.

From a liability perspective, it may be advantageous to transfer rental properties into LLCs. In the event that a tenant or guest is injured in the rental properties, the existence of the LLC will help protect

the donor's personal assets from being taken in satisfaction of a legal judgment against him or her.

Question. Do these Medicaid irrevocable trusts have to file separate income tax returns and, if so, does that result in an increased income tax liability?

Answer. These trusts are considered grantor trusts and should file an income tax return, but all the elements of income, deductions, credits, and the like should also be reported on the grantor's return. It is also important that the trust obtain a separate tax identification number for this purpose. In addition, having this separate tax identification number also helps maintain the integrity of the trust for Medicaid eligibility purposes. However, because the trust is a wholly owned grantor trust for income tax purposes, as described above, the trust will effectively not pay any separate federal income taxes. Instead, this grantor trust status causes the donor to be treated as the owner for income tax purposes and essentially flows the income through the trust and causes it to be reported on the individual donor's income tax return, Form 1040, just as was done prior to the establishment of this irrevocable trust.

Therefore, these Medicaid irrevocable trusts are known to be income tax neutral, resulting in no increase or decrease in income tax liability to the donor. The donor will continue to pay the same tax as he or she did prior to the establishment of the irrevocable trust.

Question. Do the trust assets receive a step-up in basis for capital gains tax purposes upon the death of the donor?

Answer. Yes, the assets will get a full step-up in basis on the death of the donor due to the fact that the donor retained the right to the income in accordance with Section 2036. This will cause the assets to be included in the estate of the donor, thereby receiving the step-up in basis under Section 1014.

This step-up in basis rule can be important in reducing future capital gains tax liability associated with the sale of the property following the death of the donor. A step-up in basis means that the cost basis in the hands of the beneficiaries following the death of the donor would be equal to the fair market value of the asset received as of the date of the donor's death. Therefore, if the beneficiaries of the asset were to sell it shortly after the donor's death, it would result in little to no capital gains tax liability to the beneficiaries.

For example, if the donor of the trust had purchased the home long ago for $50,000 and had approximately $50,000 of capital improvements during the donor's lifetime, that would result in the donor's cost basis of the property being equal to $100,000. Assume the donor transferred this property to an irrevocable Medicaid trust and upon the donor's death the property was worth $400,000. Upon the death of the donor, the beneficiary of this property would receive a cost basis equal to its fair market value of $400,000. If the beneficiary then sold the property for approximately $400,000, which would be the fair market value, there would be no capital gains tax to be paid by the beneficiary.

This should be contrasted with individuals who opt to give away their home or other highly appreciated rental property to their children prior to their demise. Such a transaction would result in a carryover basis in the hands of the donee/beneficiary. A carryover basis means that the donee/beneficiary of the property transferred during life would have the same basis as the donor immediately prior to the transfer.

In the example, that would mean that the donee/beneficiary, the child, would have a cost basis in this real estate equal to $100,000. In the event the donee/beneficiary sold the property following the death of the donor, the capital gain would be $300,000 ($400,000 - $100,000). Assuming at 20% federal capital gains tax rate, a 5% state capital gains rate, and applying the new net investment income tax rate of 3.8%, the capital gains tax would be approximately $86,400. The Medicaid irrevocable trust's ability to conserve this step-up in basis benefit is extremely important. This basis step-up would apply to not only real estate, but any investment portfolios or stocks transferred to the trust that may have appreciated over time.[18]

Question. Is a gift tax liability associated with transferring significant wealth into these Medicaid irrevocable trusts?

Answer. No gift tax liabilities are associated with transferring assets to these irrevocable trusts because the gifts to these trusts are known as incomplete gifts for gift tax purposes because the donor retains the right to designate the final beneficiaries of the trust in accordance with Reg. 25.2511-2(c).[19] In addition, no gift tax returns are required to be filed to report the transfer to the trusts, except if the donor wishes to disclose the transfer to commence the running of a statute of limitations for auditing the gift.[20]

A gift tax return should probably be filed, if only to provide full disclosure. If the donor included a provision in the trust rendering the gift incomplete, the regulations provide that a gift should be disclosed on a gift tax return, but a failure to file would not render the taxpayer subject to any penalties or gift tax. In most cases, no gift tax return would have been filed. The risk is that the transfer was not incomplete and gift tax would have been due, giving rise to penalties. Under Reg. 25.6019-3(a), “[i]f a Donor contends that his retained power over property renders the gift incomplete and hence not subject to the tax as of the calendar quarter or calendar year of the initial transfer, the transaction should be disclosed in the return for the calendar quarter or calendar year of the initial transfer and evidence showing all relevant facts, including the copy of the instrument of transfer, shall be submitted with the return.

Question. Does the donor have to sell his or her assets inside the donor's investment portfolio prior to transferring them into the trust?

Answer. No. In general, the funding of an irrevocable trust does not result in any income-tax-related issues whatsoever. In other words, funding the trust generally means nothing more than retitling the existing assets to the name of the trust. For instance, suppose the donor has an investment account

at Fidelity. The donor has been receiving statements from Fidelity in his or her own name, which is indicated in the upper left corner of the statement. Once this Fidelity account has been successfully retitled to the name of the irrevocable trust, the donor of the trust will continue to receive these same statements from Fidelity with all the same investments listed on them. The only difference will be that the name of the irrevocable trust along with the trustee's name will appear in the upper left corner of the statement. No adverse income tax consequences are associated with retitling assets to the trust, as nothing was sold prior to the transfer.

Question. How does a donor transfer real estate to the irrevocable Medicaid trusts, and are there any adverse income tax consequences?

Answer. The funding of a trust with real estate is generally done through the preparation of a new quitclaim deed. The deed simply transfers the property from the individual name of the donor to the name of the trustee of the irrevocable trust. The new deed and a trustee certificate are then filed at the registry of deeds. No adverse income tax consequences are associated with this transfer, nor is there any gift tax liability due.

Question. Are there any investment limitations on the trustee of a trust?

Answer. The trustee of a trust can invest in all of the same investment options that would be available to an individual. Choices are not limited by having the assets invested inside a trust. The trustee should, however, follow the prudent investment rule as a guide towards making investment decisions. The only caveat, of course, is that there are no individual retirement accounts owned inside of an irrevocable trust, as mentioned above.

Question. Can these irrevocable trusts be changed in any way after they are created and, if so, how?

Answer. While the trust is irrevocable, it nevertheless can be changed through the use of a limited power of appointment, as mentioned above. This is a power in the trust in which the donor is granted the ability to change the beneficiaries of the trust but generally is limited to a class consisting of the donor's children of all generations and charities. This power enables the donor to retain a significant degree of flexibility to adjust his or her wishes as life events unfold after the creation of the trust.

For example, a donor may wish to leave a little more assets to grandchildren or perhaps may find that one child is doing extremely well financially while another child is struggling and may desire to reallocate the percentages in which the children are to receive assets, all of which can be done through the use of exercising this limited power of appointment. The donor cannot, however, add a person as a beneficiary to the trust who was not already a member of the class of beneficiaries. The class of beneficiaries can be increased to include siblings or nieces and nephews or as needed to accommodate any family situation. Sometimes making the class larger when the trust is initially drafted may provide even greater flexibility later.

Finally, this limited power of appointment may also entitle the donor to completely eliminate any child or grandchild from receiving any benefits and thereby offers a significant degree of control in the event a child during life does not cooperate.

Question. Can the donor add assets to the irrevocable trust many years later?

Answer. Yes, assets can be added to the irrevocable trust at any time after the trust has been created. However, the addition of assets to the trust will result in the creation of a new five-year lookback period, but the lookback period will be associated only with those assets that were transferred. The creation of this new lookback period for those newly transferred assets will in no way affect the lookback period for previously contributed assets. In other words, if the donor had contributed assets to the trust five years earlier and only now wishes to put additional assets into the trust, the assets that were put into the trust five years earlier will remain protected from the cost of long-term care. The new lookback period will apply to only the newly added assets.

Question. Is it important to use one or two irrevocable trusts when doing this type of asset protection planning?

Answer. A donor who is single would need only one irrevocable trust. A married individual, however, with assets exceeding, for instance, $1 million for a resident of Massachusetts or Maine, $1.5 million for Rhode Island, or $2 million for someone who lives in Connecticut, or may exceed any of these state exemption amounts over the balance of his or her lifetime, should consider two irrevocable trusts. The reasoning behind two irrevocable trusts is to help the donor more fully use both of his or her federal and state estate tax exemption equivalent amounts, thereby serving to reduce estate tax liability. In other words, these Medicaid irrevocable trusts can also help the donor reduce estate tax liability while simultaneously serving to protect assets from the cost of long-term care. A discussion on the reduction of estate tax liability and how the trusts are designed to accomplish that is beyond the scope of this article.

Question. Can the donors borrow against any real estate that has been transferred to the irrevocable trust?

Answer. Once real estate has been transferred to these irrevocable trusts, the donor generally cannot borrow against the property any more. This is usually not a concern for many of the elderly folks who do this type of planning, as they have paid off their mortgages and are not interested in going into debt. In the event the donor happens to have an existing mortgage on the property but wishes to transfer it into one of these irrevocable trusts, the transfer of an existing debt to the trust will not trigger the due-on-sale clause but the donor will be prohibited from refinancing such debt. Therefore, it is important that any such encumbered property being transferred to the trust have a fixed-rate mortgage for the life of the loan.

If borrowing against the property in the future is of importance to the donor, then the donor should establish a home equity line of credit prior to transferring the property to the irrevocable trust. This will enable the donor to borrow against that equity line after the property has been transferred to the trust. Once the equity line expires, however, the donor would not be able to renew it.

Question. Can the donor receive principal from the trust?

Answer. The trustee must be prohibited from distributing principal directly to the donor, as this is the paragraph that provides the protection from the costs associated with long-term care. Generally, this is also not a problem for most of the people who use these irrevocable trusts, as they are usually living off of their income. Remember, the income, such as Social Security benefits, pensions, any interest and dividends generated from assets inside the trust, rent generated from inside the trust, or, of course, any IRA-type assets which are outside the trust, are all available to the donor after the trust is established. This flow in income generally is enough to allow the individual to continue to maintain the lifestyle he or she was used to prior to establishing the trust.

In the event extraordinary events arise and principal is needed in the future, the donors of the trust generally look to assets that were left outside of the trust to spend first (e.g., the IRA assets). Remember, these assets will remain at risk and, therefore, should be spent down prior to any assets that are in the trust which would be protected from the cost of long-term care and preserved for and used by the surviving spouse.

Question. What money would be available if a major repair is needed on the home, and where does the money come from?

Answer. The trust money can be used to maintain other trust assets. If a new bathroom or a new roof is needed on the vacation home or rental property that is owned by the trust, the trustee is permitted to use money or investments that are inside the trust in order to make these improvements. In fact it is important that such improvements are done in this manor and not paid by the donor out of personal non-trust assets as that would look like a gift is being made by the donor to the trust—which would result in a new five-year waiting period for those transferred assets. Remember, the donor does not own the real estate in the trust so he or she should not be paying for these home improvements but the trust can and should pay for them. A donor who reserved a life estate on the home can pay all bills and expenses and improvements for the house right out of his or her personal account.

Conclusion

The scrutiny of Medicaid irrevocable income-only trusts will continue. Thus, the effectiveness of these trusts will be based upon the language used in drafting them. With proper drafting, these trusts remain an acceptable planning tool for protecting assets from the cost of long-term care.

[1] See Pfannenstiehl v. Pfannenstiehl, 88 Mass. App. Ct. 121 (2015).

[2] See Cohen v. Commissioner of Div. of Medical Assistance, 423 Mass. 399 (1996); Doherty v. Dir. of Office of Medicaid, 74 Mass. App. Ct. 439 (2009).

[3] See Doherty, *supra* note 2.

[4] See *Cohen, supra* note 2.

[5] See Fair Hearing No. 1222688 (holding fiduciaries given power to distribute principal under broad powers of G.L. c. 190B, §7-401, and so silence in trust allows distributions of principal). General Laws c. 190B, §7-401, was repealed when the Massachusetts Uniform Trust Code (MUTC) was enacted. See St. 2012, c. 140, §51. However, the MUTC provides for specific powers of the trustee that are substantially similar. G.L. c. 203E, §816.

[6] See Edholm v. Minnesota Dept. of Human Services, No. 27-CV-11-23237 (Minn. App. Ct., 6/17/2013).

[7] 89 Mass. App. Ct. 312 (2016).

[8] See also G.L. c. 203D, §18(a) (creating presumption that additions to trust default to principal).

[9] Doherty, *supra* note 2.

[10] See Section 675(4)(C).

[11] See Heyn, *supra* note 7 (right of substitution does not cause trust assets to be countable).

[12] See In re Estate of Melby, 841 N.W.2d 867 (Iowa, 2014) (trust assets countable because of ability to pay expenses of donor).

[13] See Ledger v. Commissioner of Division of Medical Assistance (describing practice of donor appointing self as trustee as unappetizing maneuver).

[14] See Heyn, *supra* note 7.

[15] Note 13, *supra.*

[16] Note 2, *supra.*

[17] See Heyn, *supra* note 7.

[18] See Sections 1014 and 2036.

[19] See also Section 2511.

[20] Reg. 25.6019-3(g).

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