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Testamentary Trusts: The Hidden Jewel

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Despite the current Medicaid environment of ever-changing qualification rules, strategies still exist which can preserve assets for the benefit of the Medicaid recipient, his spouse, and his family. This article will examine a strategy of "qualifying" transfers, i.e., those made via testamentary trusts or to spouses. These transfers should be considered in every appropriate instance in order to preserve the home without jeopardizing Medicaid eligibility and in addition to avoid after-death estate recovery.

Testamentary Trusts And Inter-spousal Transfers:

The testamentary trust is an excellent, but underused strategy which should merit increased attention by practitioners, as it provides a "safe harbor" in the Medicaid rules. The statutory and regulatory language at both the federal and state level focuses upon the inter vivos trust and its subsequent status in qualifying the settlor/beneficiary or spouse for Medicaid assistance. The federal regulation found at 42 U.S.C. §1396p(d)(2)(A) imposes restrictions upon trusts established "other than by will." Similarly, the Massachusetts regulation at 130 CMR 505.160(J) also excludes from its definition of Medicaid qualifying trusts as "trust established by will." Thus, testamentary trusts enjoy a protected status in Medicaid qualification. This permits an individual who is the beneficiary of a testamentary trust to treat the entire trust corpus and income as a non-countable asset. Thus, his status in qualifying for Medicaid assistance is determined entirely without

regard to the existence or size of the testamentary trust. Prior to the federal enactment of "OBRA 1993," it was clear in Massachusetts that an inter vivos trust funded through a pour-over will would be deemed a testamentary trust for purposes of this exception. This is because the language of 130 CMR 505.160(J)(2) provides that a testamentary trust is one which is funded "by or through a will." This allowed practitioners the dual advantage of acquiring the protected status of a testamentary trust while avoiding the probate process during the on-going administration of the trust. OBRA 1993 replaced the earlier "by or through a will" language with the phrase, "other than by will." This change has created uncertainty as to whether inter vivos trusts funded with pour-over wills will continue to enjoy this protected status. Massachusetts has been disinclined to implement the provisions of OBRA 1993, leaving practitioners without guidance. Therefore, the safer course is to utilize a straight-forward testamentary trust which clearly qualifies as a protected resource. Furthermore, even if a pour-over will funding an inter vivos trust is determined to be acceptable in meeting the testamentary trust provisions, practitioners should continue to avoid the inter vivos trust vehicle, even though the use of a testamentary trust will mean ongoing court supervision. This is because of the possibility that estate recovery may be expanded in the future to include non-probate assets. The estate recovery provision at 42 U.S.C. §1396p(b)(4)(B) expressly defines an estate to include, inter alia, any asset "in which the individual had any legal title or interest at the time of death...including...living trust." Thus, if the Medicaid recipient is the beneficiary of an inter vivos trust funded through the pour-over will of a deceased individual,

the possibility exists that any expanded estate recovery law could include the beneficiary's interest in the living trust. If the Medicaid recipient is the beneficiary of a testamentary trust, no estate recovery will be possible since the trust is not a living trust.

The Testamentary Trust And The Institutionalized Spouse

This strategy is particularly helpful in a spousal situation where one spouse is entering the nursing home for whom Medicaid assistance will be sought. After Medicaid eligibility is achieved, the institutionalized spouse is required to remove his name from all countable assets in excess of \$2,000, but there is no requirement that his name be removed from the deed to the principal residence. The concern is that all too frequently, it is the so-called "healthy" spouse who dies first. If the title to the home is held in joint names, this will produce catastrophic results since the house will pass automatically to the institutionalized spouse as the surviving joint owner, and he will inherit the cash which had been allocated to the community spouse (the community spouse resource allowance, hereafter "CSRA"). The inheritance of the CSRA assets will render the institutionalized spouse immediately ineligible for further Medicaid assistance until these assets have been spent down, and the acquisition of sole ownership of the house as the surviving joint owner will permit the DMA to place a life-time "notice" lien against the property, preserving its rights for future estate recovery against the property. It is far preferable to restructure the assets to prevent this result. This is done by having the institutionalized spouse execute a deed conveying his interest in the home to the at-home spouse. Such a conveyance is an inter-spousal transfer and is thus fully permitted under both federal and state Medicaid law. If the

institutionalized spouse is incompetent, this conveyance can be accomplished with a properly drawn Durable Power of Attorney. The community spouse can then execute a new will providing a testamentary trust for the benefit of the spouse. The trust can even be fully discretionary, allowing all payments of income and principal to be made solely within the trustee's discretion. Cases have arisen, however, in other states wherein the Medicaid authorities have challenged the trust provisions and sought to require the trustee to make distributions sufficient to pay for the beneficiary's nursing home care. In those cases, the courts have consistently sought to determine the intent of the testator. When the will is silent as to the testator's intent, merely providing for distributions in the trustee's discretion, some Courts have interpreted this to mean that the testator intended the trust to pay for the beneficiary's health and medical needs, including nursing home costs. Such an interpretation is obviously the opposite of desired result, and accordingly, the testamentary trust should contain supplemental needs language to provide guidance and instruction to the trustee. This language will provide a clear statement of the testator's intent that the trust be used to supplement the beneficiary's needs and not supplant any public or private benefits to which he might be entitled. Whenever the testator's intent could be determined, courts have consistently upheld such trust provisions. Thus, the conservative approach is to include language in the trust sufficient to clarify the testator's intention to provide supplemental, rather than primary, benefits to the beneficiary. Some clients are tempted to have the new will exclude the institutionalized spouse completely and leave all assets to the children. This is not wise, as it might trigger a will contest. If the surviving spouse is the beneficiary of the testamentary trust, a strong argument can be made against requiring the spouse to waive the will, on the grounds that the surviving spouse will receive a greater benefit as the beneficiary of the testamentary trust funded with decedent's entire residuary estate, rather than the smaller statutory forced share.

The Testamentary Trust And the Healthy Couple - The 'Goldilocks' Strategy

The testamentary trust is also an excellent estate planning tool for couples worth less than \$600,000 even when both parties are healthy and a nursing home placement is not imminent. These couples typically execute reciprocal wills leaving all to the other spouse (the so-called "I love you" will). Since they are worth less than \$600,000, this type of will is normally acceptable, except for the need to plan for catastrophic long-term illness. A significant planning opportunity exists with the use of testamentary trusts. Here, each spouse executes a will containing testamentary trust provisions for the other, with appropriate supplemental needs language. Since we do not presently know which spouse will die first, we must assume that each might be the first to die. In that situation, the testamentary trust will provide protection for the surviving spouse as to any assets inherited from the deceased spouse. However, the trust will only include those probate assets standing in the name of the deceased spouse at the moment of death. If all assets are jointly held (as is typically the case), then nothing will fund the testamentary trust, thus causing the loss of this planning strategy. Therefore, in addition to the execution of the will documents, care should be taken to "dis-joint" the assets. The goal is to have approximately one-half of the assets in each individual spouse's name. Bank accounts and other investments should be held half in the husband's sole name and half in the wife's name. A new deed should be recorded changing the form of ownership on all real estate to tenants in common. Change of beneficiary forms for life insurance should be completed, removing the spouse as the beneficiary and naming the individual's own estate. Consideration should be given to also changing the beneficiary on pension plans, such as IRAs and 401Ks. However, the negative consequences in the income taxation of these assets when the spouse is not the beneficiary should also be considered, and it may therefore be preferable to leave the spouse as the beneficiary of these assets. After the assets have been dis-jointed, if one

spouse dies unexpectedly, one-half of the assets will receive the protection of the testamentary trust, so that if the surviving spouse should require nursing home care in the future, these trust assets will be protected in qualifying for Medicaid. If it becomes apparent that one spouse is going to die, the "healthy" spouse can improve her future position by transfer of her "half" of the assets to the "dying" spouse. Then, when that spouse does, in fact die, ALL assets, rather than merely half, are included in his probate estate, and thus flow into his testamentary trust. This strategy might be called the "Goldilocks" strategy, because complete success hinges upon the terminal spouse dying "not too quickly" (before all assets are transferred to him) and "not too slowly" (since he will himself then be needing a nursing home, necessitating a complete reversal in strategy), but rather "just right"! Naturally, consideration should be given to the increased estate tax ramifications and the impact upon claims against the decedent's estate. The testamentary trust is not a "qualified terminable interest" and therefore is not eligible for the marital deduction. Thus, this strategy should only be used in situations where the total estate is valued at less than \$600,000. Additionally, assets which flow through the decedent's estate are available to satisfy the claims of creditors prior to the funding of the testamentary trust. Therefore, careful consideration should be given as to whether there are likely to be substantial creditors.

Conclusion

In summary, the testamentary trust should always be considered when one spouse has entered the nursing home. The testamentary trust guards against the possibility that the healthy spouse will predecease the institutionalized spouse, thus preserving the assets for the supplemental needs of the nursing home spouse. If both spouses are healthy, and neither estate taxes nor creditors is a concern, then consideration should be given to utilizing the testamentary trust as an estate planning tool, and re-positioning the assets to maximize the "Goldilocks" strategy.

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