Protecting the Client's Most Precious Asset - The Home

Considerations Regarding Home Transfers

by

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I. Intro

a. Our elderly clients will frequently own a home when confronted with the need for long term care. Most often it is their most valuable and precious asset. They will expect you to develop plans to protect it. However, the tax and public benefits considerations in developing this plan are complex. This presentation will provide you with the tools and information you need to develop the plan to save their home.

A. General rules

i. In general, for determining Medicaid eligibility, the "home" is a non-countable resource.[1]

1. But see the maximum equity requirement in your state[2] for medical assistance payment for nursing facility services or other long-term care services.[3]

2. The "home" is defined as any property in which an individual (or spouse) has an ownership interest and which serves as the individual's principal place of residence.[4]

ii. However, a home *becomes* a countable resource if:

1. Absent an exception, the home ceases to be the individual's principal place of residence.[5]

a. In Virginia,"[p]roperty ceases to be the principal place of residence and is no longer excludable as the home, as of the date that an individual who has left the home determines that he does not intend to

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[1] 20 C.F.R. §§ 416.1210(a), 4151212(b) & see also Va. Medicaid Manual Section M1130.100 (A)(1).
[2] The equity in the home cannot exceed $543,000. See Va. Medicaid Manual Section M1460.150(B)(1).
[3] "The individual would not be eligible for nursing facility services or other long-term care services if the equity in the home exceeds $543,000." But states have the ability to increase this amount as long as it does not exceed $814,000. *See* Thomas D. Begley, Jr. and Jo-Anne Herina Jeffreys, Representing the Elderly Client, Wolters Kluwer, 2014-2 ed. 7-20 (2014).
[4] This property includes the shelter in which an individual resides, the land on which the shelter is located and related outbuildings." 20 C.F.R. § 416.1212(a).

In Virginia, this definition includes "the house and lot used as the principal residence and all contiguous property, as long as the value of the land, exclusive of the lot occupied by the house, does not exceed $5,000" but in any case in which the definition of home as provided in the State Plan for Medical Assistance in Virginia, then a home means the house and lot used as the principal residence and all contiguous property essential to the operation of the home regardless of value." Va. Medicaid Manual Section M1130.100(A)(2).

Principal place of residence is defined as the "dwelling the individual considers his established or principal home and to which, if absent, he intends to return. It can be real or personal property, fixed or mobile, and located on land or water" and "only one resource can be exempted as home property." M1130.100(A)(3).
[5] 20 C.F.R. § 416.1212(d) & Va. Medicaid Manual Section M1130.100(D)(1).

return to it."[6] However, if an individual becomes institutionalized, the home will be excluded for a period of six (6) months from the month of admission to a medical institution and after six months will be an available resource.[7]

i. For an institutionalized individual's home to remain an exempt resource after six months, the institutionalized individual will have to make and continue to make a reasonable effort to sell the property.[8]

b. EXCEPT, a home can remain an exempt resource even when it is no longer a principal place of residence if it is occupied by the individual's "spouse, his minor dependent child under age 18, dependent child under age 19, who attends school or vocational training; or a parent or adult child who is disabled and was living in the home with the person for at least one year prior to the person's institutionalization, and who is dependent upon the person for his shelter needs."[9]

2. Or, if the home is sold and not used to purchase a new home within three months of the date of receipt of proceeds, the proceeds become a countable resource.[10]

II. Things to Consider with Every House Transfer

A. Transfer Penalty

i. What is a "Transfer"?

1. A transfer takes place when an individual disposes of any asset for less than the fair market value on or after the look back date.[11]

a. The Virginia Medicaid Manual defines "asset transfer" as "any action by an individual (or other person) that reduces or eliminates the

[6] *Id*. M1130.100(D)(1).
[7] *Id*. M1130.100(D)(2).
[8] *Id*. M1130.140
[9] *Id*. M1130.100(D)(3).
[10] 20 C.F.R. § 416.1212(e)(1); *see also* Va. Medicaid Manual Section M1330.110(A)(1).
[11] 42 U.S.C. § 1396p(c)(1)(A); *see also* Va. Medicaid Manual Section M1450.001.

individual's ownership or control of an asset(s)," which includes "giving away or selling property."[12]

b. A transfer can be an action made by the individual, or the individual's spouse, any person (including a court or administrative body) with legal authority to act in place of or on behalf of the individual or individual's spouse; or a person (or court or administrative body) acting at the directions or upon the request of the individual or the individual's spouse.[13]

2. What constitutes a fair market value can create issues.

   a. In a Virginia case,[14] where a Medicaid applicant sold real estate assessed at $125,100, for $70,000 but the property privately appraised for only $85,000 because it was in disrepair; the court held that the sale of the real estate for less than the assessed value constituted a transfer of assets.

   b. The Virginia Medicaid Manual defines "Fair Market Value" as "an estimate of an asset's value if it were sold at the prevailing price at time it was actually transferred." For real property, the fair market value is "100% of the local tax assessed value.[15]"

3. A transfer that does not fall within an exempt category will incur a penalty.

ii. What is a Penalty Period?

1. A penalty period is "the period of time during which Medicaid payment for LTC services is denied because of a transfer of assets for less than market value. The length of the penalty period is based on the value of the uncompensated transfer of assets and the average cost of nursing facility care in Virginia."[16]

2. The look-back date is the date that is 60 months,[17] before the first date the individual is both (1) an "institutionalized"[18] individual and (2) has applied

[12] Va. Medicaid Manual Section M1450.003(C).
[13] *Id*. M1450.003(B).
[14] Begley & Jeffreys, *supra* citing Finerty v. Robinson, 2007 WL 4230802 (Va. App. 2007).
[15] Va. Medicaid Manual Section M1110.400(A)(1).
[16] *Id.* M1450.003(M).
[17] *Id*. M1450.003(I).

for Medicaid. The look back date "is the earliest date on which a penalty for transferring assets for less than fair market value can be imposed."[19] Thus, any transfers that took place prior to the look back date will not incur a penalty.

B. Carryover Basis

i. Consideration should be given to whether the asset, when transferred will carryover the basis from the Donor to the Donee. Meaning, if the Donee sells the assets and the basis is carried over, he or she will have to pay Capital Gains Tax on any gain from the sale over the Donor's original basis.

1. Ideally, the best transfer strategy is to transfer unappreciated assets to the Donee and reserve appreciated assets for the Donor, or transfer them to a grantor trust so that the gain on any sale of the appreciated asset can be offset by the cost of nursing home care from income tax.[20]

ii. For determining gain, assets gifted after December 1920 will retain the Grantor's cost basis in the property. However, for determining loss, if the Grantor's cost basis is greater than the fair market value at the time of the gift, the Donee's basis would be the fair market value of the property.[21]

C. Step Up in Basis

i. When assets are a part of a decedent's estate for federal tax purposes, a beneficiary of the estate may receive a "step-up" in basis with respect to those assets. Thus, the beneficiary's new basis in the asset will be the value of the asset at the date of the decedent's death. [22]

1. For this reason it is often important to obtain an appraisal of certain assets as valued on the date of death.

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[18] An institutionalized individual is: "[A] person who is an inpatient in a nursing facility; a person who is an inpatient in a medical institution and for whom payment for care is based on a level of care provided in a nursing facility. Included are persons in long-stay hospitals (including rehabilitation hospitals and rehabilitation units of general hospitals) and patients in Virginia Department of Behavioral Health and Developmental Services facilities who are housed in an area certified as a nursing facility or intermediate care facility or the mentally retarded; or a Medicaid applicant/enrollee who has been screened and approved for or is receiving Medicaid community-based care waiver services, services through the Program of All Inclusive Care (PACE) for the Elderly or hospice services." Va. Medicaid Manual Section M1450.003(G).

[19] *Id.* M1450.003(I); *see* also HCFA Transmittal 64 §3258.4

[20] Begley & Jeffreys, *supra* at 6-83.

[21] I.R.C. § 1015(a)

[22] I.R.C. § 1014(b)(9).

D. The 121 Exclusion

i. Internal Revenue Code Section 121 allows a taxpayer to exclude the gain that is typically applied to a realized gain from the sale of property if the taxpayer owned and used the property as his or her principal residence for periods aggregating two years or more.[23] The amount of gain excluded shall not exceed $250,000 for a single person or $500,000 for a married couple filing jointly.

E. Medicaid Treatment of Sales Proceeds

i. While owning a home may not render a Grantor ineligible for Medicaid, the proceeds received from a sale of the home often will.

ii. However, the sale proceeds from an excluded home (i.e., a principal residence) can be excluded if the individual (1) plans to use the proceeds to buy another excluded home; and (2) purchases such home within three calendar months of receiving the proceeds.[24]

1. Sale Proceeds can be used to purchase a new excluded home for costs that "stem from the purchase," including but not limited to a "downpayment, settlement costs; loan processing fees and points, moving expenses; necessary repairs to or replacements of the new home's structure or fixtures (e.g., roof, furnace, plumbing, built-in appliances) that are identified and documented prior to occupancy; and mortgage payments."[25]

F. Real Estate Tax Benefits

i. Many states provide for various tax deductions for example homestead tax rebates, veterans deductions, and senior citizens deductions. Consideration should be given to whether a tax deduction would be lost as a result of the transfer.

ii. Virginia has both a senior citizens exemption[26] and an exemption for disabled veterans.[27]

1. Each city has the ability to provide exemptions from and deferrals of taxation of real estate and manufactured homes if the real estate is owned and

[23] I.R.C. § 121: *See* Publication 523 http://www.irs.gov/publications/p523/ar02.html
[24] Va. Medicaid Manual Section M1330.110(A)(1).
[25] *Id*. M1130.110(B)(2).
[26] Va. Code Ann. § 58.1-3210(A).
[27] Va. Code Ann. § 58.1-3219.5(A).

occupied by as the sole dwelling of anyone who is at least 65 years of age or anyone who is permanently and totally disabled.[28]

2. Each city also has the ability to exempt from real estate taxes a Veteran who is: 100% service connected, permanently and totally disabled, and who occupies the property as his principal place of residence.[29] Additionally, a surviving spouse of an eligible veteran who died after January 1, 2011, who does not remarry, and continues to occupy the real property, may qualify.[30]

G. Gift Tax (Federal and State)

i. In 2014, there is a federal annual exclusion of $14,000 or less, per person per year.[31] Gifts made in excess of this amount will require that a gift tax return be filed.

ii. Additionally in 2014, there is a federal life time exclusion in the amount of $5,340,000/individual and $10,680,000/married couple, and no tax will be due for gifts that do not exceed this amount. However, the amount gifted during life will in turn reduce the amount that can pass tax free at the donor's death.

iii. Virginia does not have a Gift Tax.

H. Estate Tax (Federal and State)

i. For 2014,[32] an estate with combined gross assets and prior taxable gifts that does not exceed $5,340,000/individual and $10,680,000/married couple will not have to file a federal estate tax return.

ii. Moreover, "beginning January 1, 2011, estates of decedents survived by a spouse may elect to pass any of the decedent’s unused federal exemption to the surviving spouse."[33]

iii. In 2006 the Virginia General Assembly enacted House Bill 5018 which repealed the estate tax for the estates of decedents whose date of death occurred on or after July 1, 2007.[34]

[28] Must be totally disabled as defined in Va. Code Ann. § 58.1-3217.
[29] Va. Code Ann. § 58.1-3219.5(A).
[30] *Id*. § 58.1-3219.5(D).
[31] I.R.C. § 2503(b); http://www.irs.gov/uac/Newsroom/In-2014,-Various-Tax-Benefits-Increase-Due-to-Inflation-Adjustments.
[32] http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-Tax
[33] *Id.*
[34] http://www.tax.virginia.gov/site.cfm?alias=Estate#Repeal

I. Control and Payment of Maintenance Expenses by Grantor

i. Consideration should be given to whether the transfer would result in the Grantor losing full control and payment of maintenance expenses and whether the Grantor is ready to give up that control.

J. Encumbrances

i. Whether a property is encumbered by a lien or mortgage should also be considered.

1. If a property is encumbered by a mortgage some transfers may trigger the mortgage's due-on-sale-clause, allowing the lender to call the mortgage due and payable in full. "Almost every residential and commercial mortgage contains a clause that provides that the lender may declare an outstanding mortgage balance due and payable in full in the event there is a transfer of the property without its consent."[35]

2. In the Garn/St. Germain Depository Institutions Act of 1982, Congress attempted to clarify the types of mortgages that could legally trigger due-on-sale-clauses.[36] Thus, Congress created nine exceptions to the lender's ability to trigger the due-on-sale-clause. These exceptions include transfers to the spouse or children of the borrower and a transfer into an *inter vivos* trust in which the borrower is and remains a beneficiary.[37]

K. Estate Recovery

i. Protecting the home from Medicaid estate recovery is an important consideration. In 1993, under the Omnibus Budget Reconciliation Act, Congress mandated estate recovery in certain situations[38] and under a Medicaid Waiver program a recipient will typically only own a home, an interest in a home, and/or a personal needs account upon their death.[39]

1. For example, pursuant to the Virginia Administrative Code "[t]he Commonwealth *shall* seek recovery from the estate of an individual who was age 55 or older when that person received medical assistance" and "the Commonwealth shall recover amounts up to the total amount spent on

[35] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[36] *Id*.
[37] *Id*.
[38] Begley & Jeffreys, *supra* at 9-5.
[39] *Id*.

the individual's behalf for medical assistance for items or services provided under the State plan."[40]

2. Additionally, under the Tax Equity and Fiscal Responsibility Act ("TEFRA") Medicaid is authorized to file a lien against real property of an individual who is in a nursing home and "cannot reasonably be expected to be discharged"[41] and return home.

    a. However, Virginia does not impose liens to recover Medicaid expenditures for recipients.[42]

    b. Because Medicaid may not place a lien on a home during the protected class members life this creates tracking problems for Medicaid Recovery departments.

3. "The home is considered to be part of the recoverable estate unless it is protected for the spouse or certain other close relatives, or is conveyed outside of the State’s definition of 'estate.'"[43]

ii. In states that use a narrow federal definition of "estate," Medicaid estate recovery is limited to assets that pass through probate. However, states that have a broad definition of "estate" Medicaid may be permitted to recover some or all assets that bypass probate, which *may* include assets that pass to an heir or survivor through joint tenancy, rights of survivor ship, life estates, annuity remainder payments, or life insurance payouts.[44]

1. For example, Virginia has a broad definition of estate. Virginia Administrative Code defines "estate" as "all real and personal property and other assets held by the individual at the time of death and any other real and personal property and other assets in which the individual has *any legal title or interest* (*to the extent of such interest*) at the time of his death."[45]

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[40] 12 Va. Admin Code. § 30-20-141(C)(1).
[41] 42 U.S.C. § 1396p(a)(1).
[42] 12 Va. Admin Code §30-20-130
[43] U.S. Dep't of Health and Human Servs., Medicaid Estate Recovery Collections, Sept. 2005; http://aspe.hhs.gov/daltcp/reports/estaterec.htm
[44] U.S. Dep't of Health and Human Servs., Medicaid Estate Recovery Collections, Sept. 2005; http://aspe.hhs.gov/daltcp/reports/estaterec.htm
[45] 12 Va. Admin. Code § 30-20-141(A)

L. Insurance

i. Property Casualty & Flood Insurance

1. Keep in mind, as with every house transfer, once the home is transferred to a new owner the homeowner's liability insurance, flood insurance, and any termite policies, etc. will need to be updated to reflect the new ownership.

2. Consideration should also be given to whether any premiums may change as a result of this ownership. If the premiums will increase this should be discussed with the client before implementing the transfer.

ii. Owners Title Insurance

1. Owners Title Insurance is typically obtained at an initial purchase of real property and soon forgotten. However, when transferring any real property consideration should be given to whether the transfer will affect the Owners Title Insurance Policy. Most often a change in ownership will affect an Owners Title Policy. Thus, when transferring real property it is wise, and often required, to contact the title insurance agency to request an endorsement to extend coverage of the original policy to the new owner. While newer policies should allow for a transfer to a trust for estate planning purposes this depends on the date and specification of the client's policy. For this reason, always ask your client if they have title insurance, and write to the title company to request an endorsement to extend coverage to the new trust or verify that the title policy will remain intact.

III. The following exceptions are "exempt" transfers and will not incur a penalty period.

A. **Transfer Home to Community Spouse**

i. The residence can be transferred to the community spouse without penalty[46] because the transfer is between spouses.

1. Ex: Typically, husband and wife own the home as Tenants by the Entirety (TBE) and if one spouse enters a nursing home, and the community spouse predeceases the institutionalized spouse, than by operation of law, title to the

[46] 42 U.S.C. § 1396p(c)(2)(A)(i); Va. Medicaid Manual Section M1450.400(C)(1).

home will vest in the institutionalized spouse who would be required to sell the home and use the proceeds for nursing home care.[47]

ii. Considerations

1. Transfer Penalty

    a. No Penalty.[48]

2. Carryover Basis

    a. The Grantee spouse will maintain her spouse's original cost basis.[49]

3. Step Up in Basis

    a. As a result of a transfer, there would be no step up in basis upon the death of the Institutionalized Spouse but there would still be a full step up in basis upon the death of the Community Spouse.[50]

4. 121 Exclusion

    a. 121 Exclusion is half lost, half retained.[51]

        i. Although only one spouse needs to meet the ownership requirement, both spouses must meet the use requirement.

        ii. In order to qualify for a $500,000 exclusion as a married couple, the couple must:

            1. Be married and file a joint tax return;

            2. Either spouse must meet the ownership requirement of I.R.C. § 121(a);

            3. Both spouses must meet the use requirement of I.R.C. § 121(a); and

            4. Neither spouse has excluded gain during the two year period ending on the date of a sale of another home.[52]

[47] Begley & Jeffreys, *supra* at 8-27.
[48] 42 U.S.C. § 1396p(c)(2)(A), *see also* Va. Medicaid Manual Section M1450.400(C)(1).
[49] I.R.C. § 1015(a).
[50] I.R.C. §§ 1014 & 2036(a).
[51] I.R.C. § 121.

iii. If such spouses do not meet all requirements, the limitation shall be the sum of the limitations to which each spouse would be entitled had they not been married (i.e., $250,000).[53]

5. Medicaid Treatment of Sales Proceeds

    a. If the home was sold after the transfer to the Community Spouse the sale proceeds would not render the Grantor ineligible.

6. Real Estate Tax Benefits

    a. Most real estate tax benefits will be retained by the Community Spouse if she independently qualifies.[54]

7. Encumbrances

    a. If the home was encumbered by a mortgage a transfer to the spouse would be exempt under the Garn/St. Germain Act and would not trigger the due-on-sale-clause.[55]

8. Federal Gift Tax

    a. There is no tax because the transfer is between spouses.

9. Federal Estate Tax

    a. The value of the home post transfer will be excluded from the estate of the Grantor for federal estate tax calculations and will be included in the estate of the Grantee.

10. Control and Payment of Maintenance Expenses by Grantor

    a. As a result of the transfer, the Grantor will lose the control and obligation to pay maintenance expenses, but the control will be maintained by the surviving community spouse.

11. Estate Recovery

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[52] I.R.C. § 121(b)(3).
[53] I.R.C. § 121(b)(2)(B).
[54] Va. Code Ann. § 58.1-3210.
[55] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

a. Estate recovery can only be made after the death of the surviving spouse.[56] The transfer of the home to a community spouse will not subject the Grantor's estate to estate recovery because all assets left to the surviving spouse are exempt.[57]

i. Practice Pointer: If the property is deeded to the community spouse, and that spouse dies first, the property can be left by the will of the community spouse to the children or, in some states, to a special needs trust for the benefit of the institutionalized spouse.[58] However, be mindful of statutory elective shares.[59] For example, in Virginia disclaiming or failing to assert inheritances rights constitutes as an asset transfer.[60]

B. **Transfer Home to a Child under 21, Blind or Disabled "Exempt Children"**

i. The home can be transferred, without penalty, to a child of the institutionalized individual who is under the age of twenty-one (21), or a child of any age who is blind or disabled.[61]

1. Ex: a person who is about to enter a nursing home has a daughter who is blind. A transfer of the Medicaid applicant's home to the child who is blind would be an exempt transfer and thus no transfer penalty.[62]

2. However, when the home is transferred to an incapacitated child or a child under the age of 18, there are other consideration:

a. legal impediments to the sale of a house by a incapacitated person or a child under the age of 18, or

b. liens that may attach due to the poor credit of the recipient.

[56] 12 Va. Admin. Code § 30-20-141(C).
[57] 45 U.S.C § 1396p(a)(2(A).
[58] Begley & Jeffreys, *supra* at 8-27.
[59] Va. Code Ann. § 64.2-305.
[60] Va. Medicaid Manual Section M1450.003
[61] 42 U.S.C. § 1396p(c)(2)(A); Va. Medicaid Manual Section M1450.400(C)(1).
[62] Begley & Jeffreys, *supra* at 8-28.

ii. Considerations

1. Transfer Penalty

    a. No Penalty. The transfer of the home to a disabled child is an exempt transfer.[63]

2. Carryover Basis

    a. The exempt child will carry over the Grantor's original basis in the property unless, for determining loss, the fair market value at the time of the transfer is less than the Grantor's cost basis, in which case the exempt child's basis would be the fair market value of the property.[64]

3. Step Up in Basis

    a. Would result in a loss of Step Up in Basis at the Grantor's death.[65]

4. 121 Exclusion

    a. The Grantor would lose the ability to qualify for the 121 exclusion but the Grantee child may qualify for his or her own exclusion.[66]

5. Medicaid Treatment of Sales Proceeds

    a. A sale of the home post transfer would not render the Grantor ineligible for Medicaid, but it may hinder the Grantee child.

6. Real Estate Tax Benefits

    a. The real estate property tax exemption will be lost as to the Grantor parent but the Grantee child may qualify if the child is found to be permanently and totally disabled.[67]

7. Encumbrances

    a. If the home was encumbered by a mortgage a transfer to a child would be exempt under the Garn/St. Germain Act and would not trigger the due-on-sale-clause.[68]

[63] 42 U.S.C. § 1396p(c)(2)(A).
[64] I.R.C. § 1015(a)
[65] I.R.C. §§ 1014 & 2036(a).
[66] I.R.C. § 121.
[67] Va. Code Ann. § 58.1-3210.

8. Federal Gift Tax

    a. This transfer would require a federal gift tax return to be filed.

9. Federal Estate Tax

    a. The value of the home will be excluded from the parent's estate for federal estate tax calculations as a result of the transfer and will be included in the child's estate.

10. Control and Payment of Maintenance Expenses by Grantor

    a. The control and payment of maintenance expenses by the Grantor will be lost. However, the parent Grantor can pay the expenses for the child as an exempt transfer if they wish.

11. Estate Recovery

    a. If the Medicaid recipient is survived by a Disabled Child, the decedent's estate will not be subject to estate recovery while the Disabled Child is alive and, therefore, all assets will be protected during the lifetime of the Disabled Child.[69]

C. **Transfer Home to a Caregiver Child**

i. A "Caregiver Child" is a son or daughter[70] who:

1. is residing in the institutionalized individual's home;
2. for a period of at least two years;
3. immediately before the date the individual becomes institutionalized; and
4. who (as determined by the state) has provided care which allowed the institutionalized individual to remain at home rather than in an institution or facility.[71]

ii. In addition to meeting the above requirements, in Virginia, the following must be provided:

[68] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[69] *See* Begley & Jeffreys, *supra* at 9-11. "As long as the Medicaid recipient is survived by a disabled child, no recovery may be had at all. In fact, there is no requirement that the disabled child must reside in the home or receive the home under will."
[70] In Virginia, this does not include a step-child. *See* 12 Va. Admin Code §30-20-141.
[71] 42 U.S.C. § 1396p(c)(2)(A)(iv).

a. A Physician's Statement which provides (1) the individual's physical and/or mental condition during the two year period, (2) why the individual needed personal and/or home health care during the two year period, and (3) the specific personal/home health care service needs of the individual.[72]

b. A Statement of Services Provided from the Caregiver Child showing (1) the specific services and care he/she provided to the individual during the entire two years; (2) list of how many hours per day he/she provided the service or care; (3) whether he/she worked outside the home or from home during this time frame and how the individual's needs were taken care of while Caregiver Child was working; and (4) if the Caregiver Child paid someone to give care to the individual, then a list of who was paid, the rate of pay, the specific services, and the length of time the services were provided.[73]

c. A Third Party Statement from an objective third party who had knowledge of the individual's condition and his or her living and care arrangements during the two year period in the Caregiver Child's statement. The statement must also specify the care or services the Caregiver Child provided and who assisted the Caregiver Child when he or she was not home.[74]

iii. Considerations

1. Transfer Penalty

a. The transfer of a home to a caregiver child is an exempt transfer.[75]

b. There may be a question as to when the transfer must take place, but the home transferred must be the home which the individual resided in immediately prior to entering the nursing home. [76]

i. For example, in a New Jersey case,[77] the Burlington County Board of Social Services contended that a deed transferred 90

[72] Va. Medicaid Manual Section M1450.400(C)(3)(b).
[73] *Id*. M1450.400(C)(3)(c).
[74] *Id*. M1450.400(C)(3)(d).
[75] 42 U.S.C. § 1396p(c)(2)(A)(iv); Va. Medicaid Manual Section M1450.400(C)(3).
[76] Begley & Jeffreys, *supra* at 8-29.
[77] *See Id.*; M.S. v. Burlington County Bd. of Social Servs. & DMAHS, 96 NJ Admin. 2d (DMA) 11 (1996).

days after institutionalization did not qualify, and that such transfers need to be made within 30 days of institutionalization. However, the Administrative Law Judge found that there is no time set forth in the regulation as to when the deed must be given, but that the only reference to time is that the home must be the home in which the individual resided prior to entering the institution.

2. Carryover Basis

    a. The Caregiver Child will carryover the Grantor's original cost basis. [78]

3. Step Up in Basis

    a. There would be no step up in basis at the Grantor's death.[79]

4. 121 Exclusion

    a. The exclusion would be lost as to the Grantor, but the Caregiver Child may qualify.[80]

5. Medicaid Treatment of Sales Proceeds

    a. A sale of the home post transfer would not render the Grantor ineligible for Medicaid.

6. Real Estate Tax Benefits

    a. Any real estate tax benefits received by the Grantor would be lost unless the Caregiver Child qualifies independently for the same benefits.

7. Encumbrances

    a. If the home was encumbered by a mortgage a transfer to a child would be exempt under the Garn/St. Germain Act and would not trigger the due-on-sale-clause.[81]

8. Federal Gift Tax

[78] I.R.C. § 1015.
[79] I.R.C. §§ 1014 & 2036(a).
[80] I.R.C. § 121.
[81] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

a. The transfer would require a gift tax return to be filed.

9. Federal Estate Tax

a. The value of the home post transfer will be excluded from the parent's estate for federal estate tax calculations and will be included in the child's estate.

10. Control and Payment of Maintenance Expenses by Grantor

a. The Grantor would no longer have control over payments and the maintenance expenses of the home.

11. Estate Recovery

a. A transfer of the home during the Grantor's life to a Caregiver Child will place the home outside of the Grantor's estate prior to death and the home will not be subject to estate recovery upon the Grantor's death.

iv. **Transfer of Home to a Qualified Sibling**

1. The transfer of the home to a "Qualified Sibling" is an exempt transfer.[82] A Qualified Sibling is a brother or sister (or half-brother or half-sister, but not step-sibling) [83] of the institutionalized individual who:

a. (1) Already had an equity interest in the home prior to the transfer[84]; and

b. (2) was already residing in the home for at least one year immediately before the applicant becomes institutionalized.[85]

v. Considerations

1. Transfer Penalty

a. There will be no penalty because the transfer of a home to a Qualified Sibling is an exempt transfer. [86]

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[82] Va. Medicaid Manual Section M1450.400(C)(2).
[83] *Id.*
[84] It need not be necessary for the sibling to have had his or her name on the deed for an entire year.
[85] Va. Medicaid Manual Section M1450.400(C)(2);42 U.S.C. § 1396p(c)(2)(A)(iii).
[86] 42 U.S.C. § 1396p(c)(2)(A)(iii).

2. Carryover Basis

    a. The Qualified Sibling will retain the Grantor's original basis in the property, unless, for determining loss, the fair market value of the property at the time of the transfer is less than the Grantor's cost basis, in which case the Qualified Sibling's basis would be the fair market value of the property.[87]

3. Step Up in Basis

    a. The transfer would result in a loss of Step Up in Basis at Grantor's death.[88]

4. 121 Exclusion

    a. Would be lost as to the Grantor, but the Qualified Sibling may qualify.[89]

5. Medicaid Treatment of Sales Proceeds

    a. A subsequent sale of the home after the transfer would not render the Grantor ineligible for Medicaid.

6. Real Estate Tax Benefits

    a. Any real estate tax benefits received by the Grantor would be lost unless the sibling qualifies independently for the same benefits.

7. Encumbrances

    a. If the home was encumbered by a mortgage a transfer to a sibling would *not* be exempt under the Garn/St. Germain Act and *may* trigger the due-on-sale-clause.[90]

8. Federal Gift Tax

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[87] I.R.C. § 1015(a).
[88] I.R.C. §§ 1014 & 2036(a).
[89] I.R.C. §121.
[90] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

a. The transfer would require a gift tax return to be filed.

9. Federal Estate Tax

a. The value of the home post transfer will be excluded from the Grantor's estate for federal estate tax calculations and will be included in the Grantee's estate.

10. Control and Payment of Maintenance Expenses by Grantor

a. The Grantor would no longer have control over payments and the maintenance expenses of the home.

11. Estate Recovery

a. A transfer of the home during the Grantor's life to a Qualified Sibling will place the home outside of the Grantor's estate prior to death and the home will not be subject to estate recovery at the Grantor's death.

IV. Transfers with Penalty Period

A. **Transfer of Home to Child Outright**

i. Clients often consider transferring their home to their adult, non disabled child outright; however, this strategy comes with many drawbacks.[91] Drawbacks to include 1) the asset could become involved in any subsequent matrimonial actions, 2) the Grantee child could squander the assets, or 3) if that child is a parent, the assets could be counted against their children if they apply for financial aid.[92]

ii. If this approach is taken, an application cannot be made to Medicaid until after the look-back period has expired.

1. If institutionalization becomes necessary before the look back period has expired the transfer can be handled in three ways:[93]

a. (1) Have client retain sufficient assets to pay for the nursing home, during the period of ineligibility and transfer the remaining assets;

b. (2) Transfer all of the client's assets to the children and have the children pay for the nursing home during the period of ineligibility; or

[91] Begley & Jeffreys, *supra* at 8-123.
[92] *Id*. at 8-24.
[93] *Id*. at 8-63.

c. (3) Request a Hardship Waiver.[94]

v. Considerations

1. Transfer Penalty

   a. Unless the application to Medicaid is made after the look-back period has expired, the transfer will be subject to a penalty.[95]

2. Carryover Basis

   a. The Grantee child will carryover the Grantor's original basis in the property.[96]

3. Step Up in Basis

   a. Would result in a loss of Step Up in Basis at Grantor's death.[97]

4. 121 Exclusion

   a. The Grantor's ability to use the 121 Exclusion will be lost. However, if the child meets the requirements they may use their own exclusion.

5. Medicaid Treatment of Sales Proceeds

   a. A sale of the home after the transfer would not render the Grantor ineligible for Medicaid.

6. Real Estate Tax Benefits

   a. Any real estate tax benefits received by the Grantor would be lost unless the child qualifies independently for the same benefits.

7. Encumbrances

   a. If the home is encumbered by a mortgage a transfer to a child would be exempt under the Garn/St. Germain Act and would not trigger the

[94] Va. Medicaid Manual Section M1450.700.
[95] *Id*. Section M1450.004.
[96] I.R.C. § 1015(a)
[97] I.R.C. §§ 1014 & 2036(a).

due-on-sale-clause.[98] However, any judgment liens against the child would attach as secondary liens.

8. Federal Gift Tax

    a. The transfer would require a gift tax return to be filed.

9. Federal Estate Tax

    a. The value of the home post transfer will be excluded from the parent's estate for federal estate tax calculations and will be included in the child's estate.

10. Control and Payment of Maintenance Expenses by Grantor

    a. The Grantor would no longer have control over payments and the maintenance expenses of the home.

11. Estate Recovery

    a. A transfer of the home during the Grantor's life to a child outright will place the home outside of the Grantor's estate prior to death and the home will not be subject to estate recovery at the Grantor's death.

B. **Transfer of Home to Child with Retention of Life Estate**

i. The client transfers a remainder interest in the home and retains a life estate for themselves. Clients are typically more comfortable with this approach because it allows them to maintain control during their lifetime. However, as you will see below, there are disadvantages to this approach and this strategy is not recommended.

    1. In Virginia, a life estate can only be conveyed through a deed or will.[99]

ii. Considerations:

    1. Transfer Penalty

        a. There will be a transfer penalty but, reserving a life estate can significantly reduce the penalty period because the penalty is calculated based off the remainder interest.[100]

[98] Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[99] Va. Code Ann. § 55-2.

2. Carryover Basis

    a. The parent's basis in the home will carryover to the child's remainder interest.[101]

3. Step Up In Basis

    a. If the home is not sold during the parent's lifetime, the children would receive a full step up in basis at the parent's death.[102]

4. 121 Exclusion

    a. The exclusion will be lost as to the remainder interest held by the child since the home is not occupied by the children as their primary residence.[103]

5. Medicaid Treatment of Sales Proceeds

    a. This strategy is not typically recommended because a significant disadvantage to this approach is that if the home is sold during the lifetime of the life estate retained, the life tenant is entitled to their respective portion of the sale proceeds which could render them ineligible.

6. Real Estate Tax Benefits

    a. Generally, a person reserving a life estate retains the obligation to pay real estate taxes on the home, and thus remains entitled to those deductions.[104] The life tenant may also be able to deduct the real estate taxes from his or her federal income taxes.[105]

7. Encumbrances

    a. A transfer of a home encumbered by a mortgage to a child with retention of a life estate by the Grantor appears be exempt under the

[100] *See* Va. Medicaid Manual Section M1140.110(B)(5) and M1140.120 Life Estate and Remainder Interest Tables.
[101] I.R.C. § 1015(a).
[102] I.RC. § 1014(b)(9). *See* § 6.06[A][5][b].
[103] I.R.C. § 121.
[104] Va. Code Ann. § 58.1-3210(B).
[105] I.R.C. § 1604(a); Treas, Reg. § 1.164-1(a).

Garn/St. Germain Act and would not trigger the due-on-sale-clause.[106]

8. Federal Gift Tax

    a. An irrevocable gift of the remainder interest is subject to federal gift tax. Typically, the value of the gift for tax purposes is the entire value of the property and the value of the life estate is not subtracted. [107]

    b. The annual gift tax exclusion cannot apply because the transfer would be a future interest.

9. Federal Estate Tax

    a. For estate tax purposes, the full value of the property will be included in the estate of the grantor/life tenant.[108]

10. Control and Payment of Maintenance Expenses:

    a. Unless otherwise specified by contract (i.e., in the deed), a life tenant has the right to collect income and the obligation to pay expenses.[109]

        i. Thus, if the property is rented while the life tenant is institutionalized the income from the rental is attributable to the institutionalized individual for Medicaid income eligibility purposes and this can serve as a disadvantage.

11. Estate Recovery:

    a. Typically, in states with a broad definition of estate (like Virginia) the value of the life estate can be subject to recovery.

        i. However, an argument can be made that in Virginia there should be no estate recovery at death because the Virginia Administrative Code defines "estate" to include "any other real and personal property and other assets in which the

[106] *See* Exemption No. 6 "a transfer where a spouse or children of the borrower become an owner of the property." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[107] Begley & Jeffreys, *supra* at 8-60. & I.R.C. § 2702.
[108] I.R.C. § 2036.
[109] *See* Va. Code Ann. §§ 64.2-1030(A) & 64.2-1024(3).

individual had any legal title or interest (*to the extent of such interest) at the time of his death*,"[110] and the decedent does not own any interest at the time of his death.

C. **Transfer Home to Child and Reserve Right to Use & Occupy**

i. A right to use and occupy is a variation of a life estate. With a "right to use and occupy," the person reserves only the right to use and occupy the property and not the right to collect rent or to share in the proceeds of any sale.[111] The grantor should reserve the right to use and occupancy in the deed conveying title to the home. Upon vacating the property the right to use and occupy ceases. The Health Care Financing Administration ("HCFA") in Transmittal 64 does not value a right to use and occupy.[112]

ii. Considerations

2. Transfer Penalty

   a. The transfer will be subject to a transfer penalty.[113]

3. Carryover Basis

   a. The Grantor's basis would carryover to the Grantee child.[114]

4. Step Up in Basis

   a. By retaining the right to use and occupy, the Grantor retains an interest under the Internal Revenue Code which would provide the child with a step up in basis on the death of the Grantor.[115]

5. 121 Exclusion

   a. The Grantor's ability to claim the exclusion would be lost.[116]

6. Medicaid Treatment of Sales Proceeds

[110] 12 Va. Admin. Code § 30-20-141(A).
[111] See Begley & Jeffreys, *supra* at 8-69.
[112] *Id*.
[113] Va. Medicaid Manual Section M1450.545; 42 U.S.C. § 1396p(c)(1)(A).
[114] I.R.C. § 1015(a).
[115] I.R.C. §§1014 & 2036(a).
[116] I.R.C. § 121.

a. A subsequent sale of the home after the transfer would not render the Grantor ineligible for Medicaid because the Grantor is not entitled to any proceeds.

7. Real Estate Tax Benefits

    a. In Virginia, a person reserving a right to use and occupy would likely retain the obligation to pay real estate taxes on the home[117] and thus would likely remain entitled to those deductions.[118]

8. Encumbrances

    a. A transfer of a home encumbered by a mortgage to a child with retention of a right to use and occupy by the Grantor appears be exempt under the Garn/St. Germain Act and would not trigger the due-on-sale-clause.[119]

9. Federal Gift Tax

    a. The transfer would require a gift tax return to be filed.

10. Federal Estate Tax

    a. The entire value of the home would be included in the estate of the Grantor.

11. Control and Payment of Maintenance Expenses by Grantor

    a. Because the Grantor retained the right to use and occupy he or she would have an obligation to pay all taxes and maintenance expenses.[120] This would be helpful to the child who may not be able to afford to pay for the expenses.[121]

12. Estate Recovery

    a. A license to use property is not a right mentioned as included in Virginia's amplified estate definition.

[117] See Va. Code Ann. §§ 64.2-1030 & 64.2-1024(3).
[118] Va. Code Ann. § 58.1-3210(B)(i). The person reserving the use would likely qualify as a "tenant for life."
[119] See Exemption No. 6 "a transfer where a spouse or children of the borrower become an owner of the property." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[120] See Va. Code Ann. §§ 64.2-1030(A) & 64.2-1024(3).
[121] Begley & Jeffreys, *supra* at 8-126.

D. **Transfer Home to Grantor Trust**

i. Two types of trusts you might consider in a Medicaid planning strategy for protecting the home are (1) an Income Only Trust ("IOT"), or (2) a Children's Trust.

ii. In a situation where a client is aging but has no immediate need for nursing home care, establishing an Income Only Trust is a promising strategy.[122] An Income Only Trust is an irrevocable trust which allows the Grantor access to income, but absolutely no access to the principal of the trust. Because the Grantor cannot access any of the principal of the trust, the trust assets will not be a countable resource for Medicaid.[123]

iii. However, you should consider using a Children's Trust over an Income Only Trust if your client is eligible for Veteran's Aid & Attendance. A Children's Trust is very similar to an Income Only Trust; however neither the income nor the principal is available to the Grantor(s).

1. The Children's Trust does not retain a right to income or principal since "[v]irtually all income of a veteran is counted, including that of the veteran's spouse and dependents."[124] Moreover, the veteran's countable income must be less than the maximum pension rate and countable income reduces the pension rate dollar for dollar.[125]

2. Based on an opinion letter from the Veteran Opinion of General Counsel "where a veteran does not hold legal title or control of the trust property, only the income received for the veteran's use is countable in determining income."[126] However, two subsequent General Counsel Opinions further call into question the use of Income Only Trusts when the client will qualify for Aid & Attendance. Where a client transferred three properties but retained a life estate in them, the VA held that the life tenant had not relinquished all rights of ownership but retained complete control over the life estates in each parcel. Therefore, all three properties were included in the life tenant's net

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[122] *Id.* at 7-76.
[123] Va. Medicaid Manual Section M1450.550(C)(2).
[124] Begley & Jeffreys, *supra* at 6-62.
[125] *Id.*
[126] *Id.* at 6-69 citing Va. Op. Gen. Coun. Prec. LEXIS 1220 (Aug. 9, 1991).

worth for VA pension purposes.[127] In the second opinion, the VA held that a self settled special needs trust was counted in the net worth of the client.[128]

vi. You would not use a Revocable Trust as a Medicaid planning strategy because when any portion of the trust's principal is available to the settlor the trust assets would be a countable resource for Medicaid.[129]

vii. Considerations when transferring a home into an Income only Trust ("IOT"):

1. Transfer Penalty

   a. The initial transfer of the home into an IOT would incur a penalty for Medicaid eligibility.[130]

      i. The strategy is to not apply for Medicaid until the five year look back period has expired. When using an IOT we typically refer to this strategy as "five year planning."

      ii. Ex: If $100,000 were transferred into an IOT in a state where the divisor was $5,000/month the period of ineligibility would be 20 months.[131]

   b. If the trust allows for transfers to third parties (for reasons discussed below) these transfers would not incur a penalty for the Medicaid recipient. [132]

2. Carryover Basis

   a. The trust will maintain the Grantor's original basis in the property.[133]

3. Step Up in Basis

   a. Because the trust assets are included in the Grantor's estate for federal estate tax purposes, the estate should receive a step up in basis as to the fair market value on the date of the Grantors death.[134]

[127] VAOPGCPREC 15-12
[128] VAOPGCPREC 33-97
[129] *Id*. Section M1450.550(B)(1).
[130] Va. Medicaid Manual Section M1450.550(C)(2)(a).
[131] Begley & Jeffreys, *supra* at 8-75.
[132] Va. Medicaid Manual Section. M1450.550(C)(2)(b).
[133] I.R.C. § 1015(a).
[134] I.R.C. §§ 1014 & 2036(a).

4. 121 Exclusion

    a. Typically, the § 121 exclusion can be maintained with the transfer of the home into an IOT because the trust is designed as a grantor trust.[135]

5. Medicaid Treatment of Sales Proceeds

    a. A subsequent sale of the home after the transfer would not render the Grantor ineligible for Medicaid.

6. Real Estate Tax Benefits

    a. In Virginia, citizens may be able to retain their real estate tax benefits after transferring their home to an Income Only Trust.

        i. Real property owned and occupied as the sole dwelling of an eligible person *includes* real property "held in an irrevocable trust under which an eligible person alone or in conjunction with his spouse possess a life estate or an estate for joint lives or e*njoys a continuing right of use or support.*"[136]

        ii. Prior to transferring a home to an IOT where the Grantor has a real estate tax benefit, you should consult with the applicable Commissioner of the Revenue concerning his or her opinion whether the benefit will be retained following the transfer.

7. Encumbrances

    a. A transfer of the home into an IOT may not be exempt under the Garn/St. Germain Act. While the Grantor is and remains a beneficiary of the income of the trust, the exemption also requires that the transfer "does not relate to a transfer of rights or occupancy in the property" and this is problematic. [137]

8. Federal Gift Tax

[135]I.R.C. § 121; see also Rev. Ruling 85-45, 1985-1 C.B. 183.
[136] Va. Code Ann. § 58.1-3210(B)(iii).
[137] See Exemption No. 8 "a transfer into an *inter vivos* trust in which the borrower is and remains a beneficiary *and which does not relate to a transfer of rights or occupancy in the property*." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

a. A transfer to an IOT can be drafted to be either a complete or incomplete gift.[138]

i. If the IOT is drafted with a limited power of appointment, then a transfer to an IOT would not require a gift tax return because the transfer would be an incomplete gift.

1. Limited Power of Appointment is anything that is not a general power of appointment[139] as defined in I.R.S. Code § 2041.

ii. If the IOT does not contain a limited power of appointment, the transfer would be a complete gift and require a tax return.

9. Federal Estate Tax

a. Because an IOT is a grantor trust the assets in an IOT would be included in a Grantor's estate for federal estate tax purposes.[140]

10. Control and Payment of Maintenance Expenses by Grantor

a. If the Grantor has a special power of appointment, they would maintain some control; however they would not have control over the payments and maintenance expenses of the home.

11. Estate Recovery

a. In Virginia, because the definition of "estate" includes "any other real and personal property and other assets in which the individual had *any legal title or interest (to the extent of such interest*) at the time of his death,"[141] the argument can be made that the only asset that may be subject to estate recovery would be any income that was not yet distributed to the Grantor. However, at the present time, the issue of estate recovery from IOT's is unsettled in Virginia. However, in other states, including New Jersey, the remaining value of the life estate is considered as part of the decedent's estate. To minimize the potential for estate recovery, the retained income interest should be discretionary. The Children's trust can be used to avoid the potential

[138] Begley & Jeffreys, *supra* at 7-81.
[139] Federal Tax Coordinator Analysis (RIA) ¶ Q-3102.
[140] I.R.C. §§ 1014, 2036, 2038.
[141] 12 Va. Admin. Code § 30-20-141(A).

estate recovery where the client does not require a retained income interest.

i. Additionally, if the community spouse was the income recipient, there should be no estate recovery.

ii. Also in order to avoid estate recovery, the home could be transferred out of the trust prior to applying for Medicaid. However, this would result in a transfer of asset penalty if the home was producing income, since income is an asset.

a. Be mindful of statutory elective share issues if a community spouse predeceases an institutionalized spouse. For example, in Virginia disclaiming or failing to assert inheritances rights constitutes as an asset transfer.[142]

viii. Considerations when transferring a home into a Children's Trust:

1. Transfer Penalty

a. There would be a transfer penalty when the assets are placed into the trust because the Grantor has given up control.[143]

b. Subsequent transfers from the trust to a third party would not create a penalty.[144]

i. The strategy is to not apply for Medicaid until the five year look back period has expired. When using a Children's Trust we typically refer to this strategy as "five year planning."

1. Ex: If $100,000 were transferred into a Children's Trust in a state where the divisor was $5,000/month the period of ineligibility would be 20 months.[145]

2. Carryover Basis

a. The trust will maintain the Grantor's original basis in the property.[146]

[142] Va. Medicaid Manual Section M1450.003(C).
[143] Va. Medicaid Manual Section M1450.550(C)(2)(a).
[144] *Id*. M1450.550(C)(2)(b).
[145] Begley & Jeffreys, *supra* at 8-75.
[146] I.R.C. § 1015(b).

3. Step Up in Basis

    a. If the trust is drafted with a special power of appointment, the IOT will be considered a grantor trust and the trust's assets will be included in the Grantor's estate for federal estate tax purposes. Therefore, the estate will receive a step up in basis as to the fair market value on the date of the Grantors death.[147]

4. 121 Exclusion

    a. According to the IRS gain on a sale from a home by a trust is excludable under Section 121 if the trust beneficiary is treated as the owner of the trust under the Grantor Trust Rules.[148]

        i. The sale of a home from a trust that doesn't meet these requirements may not qualify for the exclusion.[149]

5. Medicaid Treatment of Sales Proceeds

    a. A subsequent sale of the home after the transfer would not render the Grantor ineligible for Medicaid.

6. Real Estate Tax Benefits

    a. The real estate tax benefits previously enjoyed by the Grantor would be lost because the Grantor is not a beneficiary of the trust.[150]

7. Encumbrances

    a. A transfer of the home into a Children's Trust would not be exempt under the Garn/St. Germain Act because the Grantor does not remain a beneficiary of the trust. [151]

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[147] I.RC. §§ 1014(b), 2036, 2038.
[148] I.R.C. § 121; see also See Rev. Ruling 85-45, 1985-1 C.B. 183.
[149] IRS Letter Ruling 200018021.
[150] See Va. Code Ann. § 58.1-3210(B)(iii).
[151] See Exemption No. 8 "a transfer into an *inter vivos* trust in which the borrower is and remains a beneficiary *and which does not relate to a transfer of rights or occupancy in the property*." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

8. Federal Gift Tax

    a. The trust can be drafted with a special power of appointment such that the transfer is an incomplete gift.[152] Because the transfer would be an incomplete gift, it would not require a gift tax return.

9. Federal Estate Tax

    a. The assets in a Children's Trust would be included in a Grantor's estate for estate tax purposes.

10. Control and Payment of Maintenance Expenses by Grantor

    a. The Grantor would no longer have control over payments and the maintenance expenses of the home.

11. Estate Recovery

    a. There should be no estate recovery from a Children's Trust in Virginia because there is no retained interest.[153]

    b. However, be mindful of statutory elective share issues unless both spouses join in on the transfer of the asset to the Children's Trust. For example, in Virginia disclaiming or failing to assert inheritances rights constitutes as an asset transfer.[154]

E. **Transfer Home to Grantor Trust and Retain a Life Estate**

i. The client could transfer a remainder interest in the home to a Grantor Trust (i.e. an Income Only Trust or a Children's Trust) while retaining a life estate for himself or herself. Clients are typically more comfortable with this approach because it allows them to maintain more control during their lifetime.

    1. However, as you will see below, there are significant disadvantages to this strategy and therefore it is not recommended.

ii. Considerations:

    1. Transfer Penalty

[152] Begley & Jeffreys, *supra* at 7-81.
[153] 12 Va. Admin. Code §30-20-141.
[154] Va. Medicaid Manual Section M1450.003

a. There will be a transfer penalty but, reserving a life estate can significantly reduce the penalty period because the penalty is calculated based off the remainder interest.[155]

2. Carry Over Basis

   a. The parent's basis in the home carries over to the trust's remainder interest. [156]

3. Step Up In Basis

   a. If the home is not sold during the Grantor's lifetime, because of the retained life estate and the trust being a grantor trust, the trust will receive a step up in basis at the Grantor's death.[157]

4. 121 Exclusion

   a. The trust would maintain the 121 exclusion if it meets the Grantor requirements. [158]

      i. This is a significant benefit compared to transferring the home to the child and retaining a life estate.

5. Medicaid Treatment of Sales Proceeds

   a. This strategy is not recommended because if the home is sold during the lifetime of the life estate retained, then the life tenant is entitled to his respective portion of the sale proceeds which could render him ineligible.

6. Real Estate Tax Benefits

   a. In Virginia, a person reserving a life estate retains the obligation to pay real estate taxes on the home[159] and thus remains entitled to those

[155] *Id*. M1140.110(B)(5).
[156] I.R.C. § 1015(a).
[157] I.RC. § 1014(b)(9). *See* § 6.06[A][5][b].
[158] I.R.C. § 121.
[159] See Va. Code Ann. §§ 64.2-1030 & 64.2-1024(3).

deductions.[160] The life tenant may also be able to deduct the real estate taxes from his or her federal income taxes.[161]

7. Encumbrances

    a. While the Garn/St. Germain Act appears to allow a transfer of the property to a spouse or child while retaining a life estate, it does not appear that a transfer to either an Income Only Trust or a Children's Trust would qualify even with a retained life estate.[162]

8. Federal Gift Tax

    a. The trust can be drafted with a special power of appointment such that the transfer is an incomplete gift.[163] Because the transfer would be an incomplete gift, it would not require a gift tax return.

9. Federal Estate Tax

    a. For Estate tax purposes, the full value of the property will be included in the estate of the grantor/life tenant.[164] Or, if the life tenant is not the grantor, then the value of the property would not be included in the estate of a life tenant and no step-up in basis would be achieved.

10. Income and Payment of Maintenance Expenses by Grantor:

    a. Unless otherwise specified by contract (i.e., in the deed), a life tenant has the right to collect income and the obligation to pay expenses.[165]

        i. Thus, a potential issue arises if the property is rented while the life tenant is institutionalized because the income from the rental is attributable to the institutionalized individual for Medicaid income eligibility purposes.

11. Estate Recovery:

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[160] Va. Code. Ann. § 58.1-3210.
[161] I.R.C. § 1604(a); Treas, Reg. § 1.164-1(a).
[162] See Exemption No. 8 "a transfer into an *inter vivos* trust in which the borrower is and remains a beneficiary *and which does not relate to a transfer of rights or occupancy in the property*." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.
[163] Begley & Jeffreys, *supra* at 7-81.
[164] I.R.C. § 1014(b)(9).
[165] See Va. Code Ann. §§ 64.2-1030 & 64.2-1024(3).

a. Typically, in states with a broad definition of estate (like Virginia) the value of the life estate can be subject to recovery.

i. However, an argument can be made that in Virginia there should be no estate recovery at death because the Virginia Administrative Code defines "estate" to include "any other real and personal property and other assets in which the individual had any legal title or interest (*to the extent of such interest) at the time of his death*,"[166] and the decedent does not own any interest at the time of his death (except for any undistributed income in an Income Only Trust.

F. **Transfer Home to Grantor Trust and Retain a Right to Use & Occupy**

i. With a "right to use and occupy," the person reserves only the right to use and occupy the property and not the right to collect rent or to share in the proceeds of any sale.

1. Upon vacating the property the right to use and occupy ceases. HCFA 64 does not value a right to use and occupy. [167]

ii. Considerations

1. Transfer Penalty

a. There would be a penalty.[168]

2. Carryover Basis

a. The Grantor's basis would carry over to the trust.[169]

3. Step Up in Basis

a. If the home is not sold during the Grantor's lifetime, the trust would receive a step up in basis at the Grantor's death.[170]

4. 121 Exclusion

[166] 12 Va. Admin. Code § 30-20-141(A).
[167] *See* Begley & Jeffreys, *supra* at 8-69.
[168] 42 U.S.C. § 1396p(c)(1)(A).
[169] I.R.C. § 1015(a).
[170] I.RC. § 1014(b)(9). *See* § 6.06[A][5][b].

a. The trust would maintain the 121 exclusion if it meets the Grantor requirements. [171]

5. Medicaid Treatment of Sales Proceeds

    a. If the property is sold during the lifetime of the Grantor, he or she would not be entitled to proceeds. The proceeds would be paid into grantor trust which maintains the Medicaid recipient's eligibility.

6. Real Estate Tax Benefits

    a. In Virginia, a person reserving a right to use and occupy would likely retain the obligation to pay real estate taxes on the home[172] and thus would likely remain entitled to those deductions.[173]

7. Encumbrances

    a. While the Garn/St. Germain Act appears to allow a transfer of the property to a spouse or child while retaining a life estate, it does not appear that a transfer to either an Income Only Trust or a Children's Trust would qualify even with a retained right to use and occupy.[174]

8. Federal Gift Tax

    a. The trust can be drafted with a special power of appointment such that the transfer is an incomplete gift. Because the transfer would be an incomplete gift, it would not require a gift tax return.

9. Federal Estate Tax

    a. The home and assets in the trust would be included in the Grantor's estate for estate tax purposes.

10. Control and Payment of Maintenance Expenses by Grantor

[171] I.R.C. § 121.
[172] See Va. Code Ann. §§ 64.2-1030 & 64.2-1024(3).
[173] Va. Code Ann. § 58.1-3210(B)(i). The person reserving the use would likely qualify as a "tenant for life."
[174] See Exemption No. 8 "a transfer into an *inter vivos* trust in which the borrower is and remains a beneficiary *and which does not relate to a transfer of rights or occupancy in the property*." Leo J. Cushing, *An Estate Planner's Guide to Mortgage Due-On-Sale Clauses*, The Elder Law Report, December 1997 at 4.

a. The Grantor would lose the control and the control would be passed to the Trustee of the trust. However, by retaining the right to use & Occupy, the Grantor is required to pay maintenance expenses. [175]

11. Estate Recovery

a. Typically, in states with a broad definition of estate (like Virginia) the value of the life estate can be subject to recovery.

i. However, an argument can be made that in Virginia there should be no estate recovery at death because the Virginia Administrative Code defines "estate" to include "any other real and personal property and other assets in which the individual had any legal title or interest (*to the extent of such interest) at the time of his death*,"[176] and the decedent does not own any interest at the time of his death.

V. <u>Resources</u>

Electronic Code of Federal Regulations http://www.ecfr.gov/cgi-bin/ECFR?page=browse

HCFA Transmittal 64 §3258.4 http://www.sharinglaw.net/elder/Transmittal64.htm

Internal Revenue Code http://www.irs.gov/Tax-Professionals/Tax-Code,-Regulations-and-Official-Guidance

Leo J. Cushing, An Estate Planner's Guide to Mortgage Due-On-Sale Clauses, The Elder Law Report, December 1997 at 4.

Thomas D. Begley, Jr. and Jo-Anne Herina Jeffreys, Representing the Elderly Client, Wolters Kluwer, 2014-2 ed. (2014).

U.S. Dep't of Health and Human Servs., Medicaid Estate Recovery Collections, Sept. 2005; http://aspe.hhs.gov/daltcp/reports/estaterec.htm

Virginia Administrative Code: http://leg1.state.va.us/000/reg/TOC.HTM

Virginia Code https://leg1.state.va.us/000/src.htm

Virginia Medicaid Manual http://www.dss.virginia.gov/benefit/medical_assistance/manual.cgi

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[175] Va. Code Ann. §§ 64.2-1030(A), 64.2-1024.
[176] 12 Va. Admin. Code § 30-20-141(A).

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