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THE MECHANICS OF ESTATE AND BUSINESS GENERATIONAL TRANSITION

An Overview of Basic Estate and Long Term Care Planning Tools and Transition Issues

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What is a Transition Plan?

- Estate/generational transition planning is the entire process of arranging your assets and other affairs, both during your life and after your death, in a way that accomplishes your objectives for the disposition of your assets and the management of your personal concerns.

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What is a Transition Plan (contd.)?

- In the context of farm and ranch operations, such a plan should facilitate the transition of the operation to the next generation (or the next owner) in a manner <u>that meets the needs/goals of its current owners and addresses the expectations, *where appropriate and reasonable*, of the current (and/or future) operators</u>.

Issues to Consider/The Hard Questions:

- Your goals for the use of your assets during your lifetime
- Provision for a surviving spouse (and/or second marriage concerns)
- Disposition of assets when both spouses are gone
- Continuation of family business or farming operation
  - Control
  - Management
  - Transition Timeline

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Issues to Consider/The Hard Questions (contd.):

- Tax planning
  - Federal Estate Tax
  - Federal Gift Tax
  - Generation Skipping Transfer Tax
  - State Inheritance Tax?
  - Income Tax
- Nomination of fiduciaries to manage your concerns if you are unable to do so or after your death
- Respecting the relevant entity form, if applicable

Asset Ownership

Accidental or Intentional Planning?

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Types of Asset Ownership

- Single Name
- Tenancy in Common
- Joint Tenancy
- Trusts
- Legal Life Estates
- Beneficiary Designations on Life Insurance, Qualified Retirement Plans, Investment Accounts, or Similar
- Payable on Death Designations
- Corporations (Shareholders Agreement), Partnerships (Partnership Agreement), and Limited Liability Companies (Operating Agreement)

The Elements of a Thoughtful Transition Plan

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Elements of a Thoughtful Transition Plan

- Development of Estate Plan
  - Will
  - Trust
  - Durable Power of Attorney
  - Healthcare Power of Attorney/Living Will
  - Appointment of Fiduciaries
  - Consideration of Current Titling/Designation(s)
- Review of Potential Tax Exposure
- Review of Entity Form and Related Issues

Development of an Estate Plan

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Purpose of an Estate Plan

- Provides asset management assistance for Grantor
- Provides asset management assistance for spouse, children, or incapacitated beneficiaries
- Develops and implements plan for managing farm and ranch assets for the benefit of children in the operation as well as children off-operation or transitioning in some other manner
- May avoid probate and save estate settlement costs
- Saves (mitigates) estate and other transfer taxes

Common Estate Planning Documents

- Will
- Trust
- Durable Power of Attorney
- Healthcare Power of Attorney/Living Will

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Wills

Definition of Will

- A will is a written plan for the disposition of property after death.
- Requirements:
  - Testator of sound mind (i.e., has capacity to execute the Will)
  - Testator of lawful age (18 years old in NE)
  - Will in writing
  - Will properly signed and witnessed (two witnesses required in NE)

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Types of Wills

- Simple Will – passes property to surviving spouse and, if none, to children or other named beneficiaries
- Pourover Will – executed in conjunction with a separate trust agreement and states that all testator's assets will pour over into the separate trust agreement, which will determine the distribution of the testator's assets

Typical Will Clauses

- Specific bequests: "I give John my ring."
- General bequests: "I give John all my real estate."
- Charitable bequests: "I give my church $1000."
- Residuary bequests: "I give John all the remainder of my estate."
- Trust bequests: "I give x to my Trustee who shall hold, manage, and distribute the property as follows:…"

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Appointment of Fiduciaries

- Personal Representative – charged with collecting the decedent's assets and distributing them to new owners as well as paying taxes and paying claims
- Trustee – an agent who is charged with the management (typically, long term) of decedent's assets for the benefit of named beneficiaries
- Guardian/Conservator – individuals who are charged with the care of the decedent's minor children or a disabled beneficiary

Trusts

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Definition of Trust

- A trust is an arrangement where one person transfers legal title to property to another person or entity who then manages the property <u>for the benefit</u> of one or more other people.

Reasons for Establishing a Trust

- Provide asset management assistance for Grantor
- Provide asset management assistance for spouse, children, or incapacitated beneficiaries
- Develop and implement plan for managing farm and ranch assets for the benefit of children in the operation as well as children off-operation or transitioning in some other manner
- Avoid probate and save estate settlement costs (if the trust is fully funded at grantor's death)
- Save (mitigate) estate and other transfer taxes

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Who are the actors in a Trust?

- A person creating the trust is the "grantor," "settlor," or "creator."
- The person deriving the benefit from the property held in trust is the "beneficiary."
- Individual or entity holding title to the assets is the "trustee."

What is the Trust Agreement?

The controlling instrument that:

- Appoints the trustee
- Describes the time for establishing and terminating the trust
- Names the beneficiaries and determines their rights
- Defines the scope of the trustee's powers and duties
- Instructs the trustee in the management and ultimate disposition of trust assets

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Types of Trusts

- Testamentary Trusts
  - Created by a Will and irrevocable at death of testator
  - Property flows from the probate estate to the trustee instead of outright to beneficiary
  - Used to provide management for testator's survivors
  - Does not avoid probate
- Revocable (Inter Vivos) Trusts
  - Created and operative during Grantor's lifetime
  - Used by Grantor to manage assets during lifetime, particularly if Grantor becomes incapacitated
  - Usually continues after Grantor's death
  - Can be part of an estate tax savings plan
  - Can be used to avoid probate if fully funded prior to death
  - May be revoked or amended
  - Provisions are confidential and agreement is not filed with court in probate proceedings
  - Can fund with a durable power of attorney if Grantor becomes incapacitated
  - Used in conjunction with a pourover will

- Irrevocable Trusts
  - Life insurance trusts, education assistance trusts, or other trusts used to remove assets from the taxable estate of the Grantor
  - Can provide protection from creditors or qualification for certain types of government benefits
- Charitable Trusts
  - Complex trust planning used to move assets to charities in a variety of ways and include certain tax benefits

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Trusts In Transition Planning

- Trusts are incredibly flexible tools that allow for significant creativity and direction, if needed, to manage a wide range of entity issues and/or family dynamics. For instance, trusts can be used to address each of the following issues (alone or in combination):
  - Control/Guidance in asset management after death
  - Assets preserved for next operators while sharing benefits with off-operation beneficiaries
  - Right of first refusal – purchase or rent
  - Put/Call options
  - Management of entity interests (i.e., voting control and oversight directions)
  - Planning for disabled beneficiaries
  - Financial guidance and controls
  - Asset protection in the event of a surviving spouse's remarriage

Powers of Attorney

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Durable Power of Attorney

- Empowers an agent or agents of your choice to make a broad range of financial decisions on your behalf
  - Authority to act language should address gifting, access to safe deposit box, and a broad range of other financial issues such as tax returns, life insurance, retirement plans, Social Security, real estate, banking, etc.
- This document can be drafted so that it is effective both should you become incompetent and also should it simply be more convenient for you to have an agent acting on your behalf
- Helps avoid the necessity of seeking court appointment of a conservator to make these decisions on your behalf
- Agent is subject to fiduciary duties

Health Care Power of Attorney/Living Will

- Names an agent to make broad range of medical decisions if you are unable to do so
  - Choose treatment options
  - Check you in and out of facilities
  - View your medical records
  - Change your health care providers
- Can also include an "Advance Health Care Directive" or "Living Will"
  - This is your personal and legally binding directive to health care providers not to take extraordinary measures to prolong your life if you reach a medically nonrecoverable state
  - Removes these difficult decisions from survivors
- Can help avoid the need to appoint a guardian to make these decisions for you

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Brief Primer on Estate Taxes and Related Issues

Estate Tax Considerations

- Federal Estate and Gift Taxes (2018) – Unified Credit
  - $11.4 million exemption per person (40% is top federal tax rate) – BUT 2026…
  - Portability issues
- Gifting Considerations (i.e., Annual Exclusion Amount $15,000 per recipient)
- Nebraska State Inheritance Tax
- Step Up in Basis – Capital Gains Issues

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Long Term Care Issues

Long Term Care Options

- Private Payment
- Long Term Care Insurance/Long Term Care Hybrid Products
- Medicaid
- Combination of Private Payment, LTC Insurance/Products, and Medicaid

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When are the Medicaid Rules Implicated in a Typical Estate Planning Context?

- Farmers
- Ranchers
- Small Business Owners
- Clients using trusts as part of their estate planning
- Clients with known potential long term care issues
- Elderly clients with assets of less than $500,000
- Clients with disability issues of their own
- Clients whose beneficiaries may become disabled
- Clients with an active gifting plan who may need long term care assistance
- Petitions for Elective Share
- Disclaimers
- Estate distributions to disabled beneficiaries
- Medicaid as an estate creditor

The Basic Medicaid Rules

- Residency (Note: The rules included in your materials apply <u>only</u> to Nebraska residents.)
- Medical or Physical Criteria
  - Age 65 and older, <u>*or*</u>
  - Younger than 65 and blind or disabled
- Financial Criteria

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Financial Criteria - Income

- Income Test
  - Gain or recurrent benefit received in money or in-kind from employment, business, property, investments, gifts, benefits, or annuities, at regular or irregular intervals of time
  - Includes earned or unearned income if the income is received and currently available for the use of the individual

Financial Criteria - Resources

- Resource Test
  - Medicaid considers only <u>available</u> or <u>countable</u> resources
  - Countable resources include cash or other liquid assets or any type of real or personal property or interest in property that the individual owns or may convert to cash to be used for support and maintenance
  - Available or countable assets include any assets that Medicaid does not deem excluded

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Available or Countable Resources (complete list found in applicable regulations)

- Cash (savings or checking accounts)
- Certificates of Deposit
- Investments, stocks, and bonds
- Certain promissory notes
- Certain land contracts
- Collectable unpaid notes or loans
- Interests in LLCs, corporations, or similar entities **(Liquidation value)***
- Certain land leases
- Certain life estates*
- Excess motor vehicles
- Combined cash value of insurance policies > $1500
- Certain trusts*
- Guardianship and conservatorship funds
- Elective share of a spouse's augmented estate
- Revocable, assignable, or saleable annuity

*LB 268 does not, on its face, appear to impact countability evaluation for these assets, but will come into play in deprivation, lien, and estate recovery contexts

Excluded Resources (complete list found in applicable regulations)

- Real property applicant or spouse owns and occupies as resident with equity value of less than $585,000
- Tangible personal property of a moderate value used in the home
- Certain types of burial funds and related assets (Irrevocable Burial Trust = $5212)
- Combined cash value of life insurance policies < $1500
- One motor vehicle that is actually used for transport or as a home (by applicant or spouse)
- Retirement accounts inaccessible to applicant or spouse
- Resources used in applicant's trade or business *if* applicant, spouse, or applicant's parents are *actively involved* in day-to-day operation of business as primary source of income
- Certain life estates in real property*
- Certain trusts*

*LB 268 does not, on its face, impact countability evaluation for these assets, but will come into play in deprivation, lien, and estate recovery contexts

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Two Common Financial Scenarios

- Single person entering a nursing facility
  - $4000 in countable assets
  - All income (less small income disregard) will be contributed to the nursing home and Medicaid's budget will pay for the difference at the Medicaid rate

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- Married couple (one needing Medicaid/one living at home without Medicaid)
  - Apply under the spousal impoverishment program
  - Assessment of Resources (one time only)
  - Divide resources
    - Community spouse retains one-half of countable assets up to $126,420 (retains all assets if countable assets total $25,284 or less)
    - Medicaid spouse retains up to $4000 in countable assets
  - Designate resources
  - No income limitations
    - Each spouse takes own income unless community spouse's income < $2058
    - NH spouse's income then shared with community spouse to bring up to the $2058
  - Spend down the excess according to Medicaid rules

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Gifting = Deprivation of Assets

- Medicaid is a needs based program.
- Applicants cannot deprive themselves of resources in order to meet the applicable financial criteria.
- A deprivation of resources is any action taken by the applicant or another party on the applicant's behalf that reduces or eliminates the applicant's or his/her spouse's recorded ownership or control of an asset for less than fair market value.

Penalty for Improper Transfers

- If the applicant or applicant's agent transfers assets for less than fair market value <u>within 60 months of application for Medicaid</u>, that transfer will be deemed a deprivation of resources.
- Benefits will be withheld for the period of time the transferred asset(s) would have paid for the applicant's care.
- The penalty period will begin running once the financial criteria for Medicaid qualification are otherwise met.

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Types of Penalty Triggering Transfers

- Traditional gifts
- Sale of assets for less than fair market value
- Installment contracts or promissory notes that do not comport with Medicaid's rules
- Later payment for services freely given at the time rendered
- Disclaimers
- Failure to elect the spousal share of the augmented estate
- Any transfer above the protected spousal reserved amount to a community spouse
- Any transfer of community spouse's assets to third parties
- LB 268 – leases for less than fair market value – can DHHS enforce?

Permissible Transfers and Related Strategies in Medicaid Context

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Gifting – 60 Month Lookback Period

- Traditional Gifts
- Life Estate Deeds
  - Remainder = gift
  - Income Issues
  - LB 268 does not forbid this transfer but creates a lien in favor of the State on the remainder interest if the remainder holder is a related party as defined in the statute; lien is for full amount of medical assistance paid to transferor during lifetime that is unpaid after application of assets in transferor's probate estate
  - Consequence – life estate deeds as planning tool no longer viable
- Irrevocable Trusts
  - Assets benefit third parties
  - Grantor cannot dictate distribution to self or spouse
  - Assets transferred prior to lookback period
  - LB 268 codifies the regulations regarding retained interests in trusts; it does not prohibit/impact transfers to irrevocable trusts where the transferor retains no interests/rights in the trust and the lookback period is satisfied

Acquisition of Exempt Resources

- Home improvements
- Vehicle upgrade
- Funeral planning
- Investment in a resources used in the applicant's trade or business
- Upgrade personal property

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Preneed Funeral Planning

- Irrevocable burial trusts (for self and spouse) funded with up to $5,212 *or* segregated funds of up to $1,500 *and*
- Prepurchase monument, casket, liner, and gravesite and prepay opening/closing fees (no limit on these items beyond general reasonableness)
- LB 268 provides that assets held in trusts of this type are not considered part of the applicant's estate and are not subject to estate recovery

Annuities

- Annuity transactions occurring after February 8, 2006:
  - Revocable and assignable annuities are a countable resource
  - Annuities are excluded assets if:
    - The State is the remainder beneficiary in the primary position for at least the total amount of Medicaid benefits or in the second position behind a spouse or a minor or disabled child;
    - The annuity is irrevocable;
    - The annuity is nonassignable;
    - The annuity is actuarially sound; and
    - The annuity provides equal payments during the term with no deferral or balloon payments.
  - Other excluded annuitized annuities include IRAs or deemed IRAs under a qualified employer plan or annuities purchased with the proceeds from a simplified employee pension

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Life Insurance

- Medicaid will treat combined <u>*cash values*</u> up to $1500 as excluded assets.
- Cash value is the amount the insurer will pay to the owner of a policy to cancel the contract before the death of the insured or the maturity of the policy.
- Large policies can be adjusted to smaller amounts by taking a loan on built-up policy values or decreasing premium obligations if the contract permits.
- Interest and dividends from insurance policies actually paid to the applicant are treated as income.

Transfers to Community Spouse

- Resources designated as the community spouse's should be transferred to the community spouse's name alone.
- Community spouse must transfer title to all excluded assets into community spouse's sole name.
- Neither of these categories of assets may be gifted to third parties by the community spouse while benefits are flowing to the Medicaid spouse.

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Real Property Transfers

- Certain Home Transfers
  - Spouse
  - Son or daughter who is:
    - 20 or younger,
    - Blind or disabled, *or*
    - Residing in the home for at least 2 years pre-assistance or facility and provided care which allowed home residency without Medicaid
  - Sibling
    - Equity interest + residency one year prior
  - LB 268 recognizes that these home transfers are not subject to estate or lien recovery *provided the child or sibling resided continuously in the home since transfer*

- Installment Contracts
  - FMV terms
  - Contract term lasting no longer than life expectancy of Medicaid recipient or spouse (using *Medicaid's* life expectancy tables);
  - Equal payments beginning immediately;
  - Fair market interest rate;
  - Prohibits cancellation of any balance due at death of lender; and
  - Appropriate default language

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Trust Considerations and Medicaid

Trust Considerations

- Third Party Settled and Funded Trusts
  - Grantor's funds may be used for the benefit of a disabled beneficiary
  - Needs language to protect beneficiary who may need Medicaid assistance
  - Protects the applicant beneficiary but will not prevent countability of trust assets if grantor or grantor's spouse applies for benefits unless trust is irrevocable, no grantor-retained rights, and lookback period satisfied
- Revocable Trusts
  - Typical estate planning tool
  - Provides no protection to grantor or grantor's spouse in Medicaid context (LB 268 is consistent with this regulatory language)

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- Irrevocable Trusts
  - If grantor or grantor's spouse retains an interest in the trust, no protection from countability for Medicaid purposes (LB 268 is consistent with this regulatory language)
  - If no retained interest, grantor or spouse must wait 5 years following funding to apply for Medicaid (LB 268 is consistent with this regulatory language)
- Testamentary Trusts
  - Created by wills
  - May provide limited protection for a surviving spouse's interests in trust in very limited circumstances
  - Pohlmann v. Nebraska Dept. of Health & Human Servs., 271 Neb. 272, 710 N.W.2d 639 (2006)
  - LB 268 does not contradict the Pohlmann case

- Special Needs Trusts
  - Trust containing the assets of an applicant age 64 or younger who is disabled
  - Established for the sole benefit of the applicant by a parent, grandparent, legal guardian, or court
  - Funded with the applicant's own excess assets at any time prior to age 65
  - Payback clause required
  - Distribution criteria
  - Court approval – use of temporary or permanent guardianship process