Special Legal Report

Estate Planning in Tennessee

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"How to Avoid Probate, Nursing Home Poverty, and Estate Tax"

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About the Author

Daniel Perry lives in Franklin, Tennessee, with his wife, Catherine, and their children, William and Landon. Mr. Perry was born in Wichita, Kansas, but shortly after he was born his family moved to Indianapolis, Indiana where he was raised. He earned his law degree from the University of Dayton School of Law in Dayton, Ohio. In addition, he also received a Bachelor's degree from Purdue University and an Associate's degree from Holy Cross College in South Bend, Indiana. Prior to practicing solely in the areas of estate planning, estate settlement, and probate administration, he spent three years as a trial attorney in criminal defense, bankruptcy and civil litigation. This provides Mr. Perry with a unique insight that he uses to properly advise and serve his clients that are planning their estates so as to make everything simple for their families.

He enjoys running, reading, creative writing, music, and is an enthusiast of American Civil War History.

Mr. Perry's law practice focuses on helping families and businesses in the areas of estate planning, elder law, estate and probate administration, and business law.

Estate Planning in Tennessee

You've all heard of the phrase, "Getting your affairs in order." Well, that's a simple but effective definition of estate planning.

You don't know when you're going to die. You don't know if you'll be incapacitated during your lifetime. As a result of that uncertainty, you need to plan.

The purpose of this Special Legal Report is to educate you, the lay person, about estate planning. This Special Legal Report is specifically designed to benefit you if you live in the State of Tennessee.

Trusts

Trusts can be a great tool—when set up the right way

Trusts are complicated to the lay person. But when used properly, they can be a valuable estate planning tool. Some of the common uses for trusts include: avoiding probate, minimizing federal estate tax, protecting your children from squandering their inheritance, provide for grandchildren's education or other needs, protect your spouse from your children of a previous marriage, protect your children of a previous marriage from your spouse, protecting the inheritance of a special needs child, and much more.

What is a trust?

A trust is defined as a relationship which results when someone transfers title to an asset to a person whose job it is to administer it for another.

Example: In George's Will, he made a bequest of $50,000 to his son, George, Jr., as trustee of a trust for the benefit of George's grandson, George III. George provided, among other things, that the principal of the trust could be used for the health and education of George III, and George also provided that if the assets had not been used by the time George III reached the age of thirty, then the trust would terminate, and the remaining trust assets would be distributed to George III. When George later died, a trust account was established and George, Jr., managed the account as trustee.

Who are the people involved in a trust?

Every trust has one or more settlors, trustees, and beneficiaries. The Settlor is typically the person who sets up the trust. In the previous example, George is the Settlor. The Trustee is the person who manages the trust assets. In our previous example, George, Jr., is the Trustee. The beneficiary is the person who benefits from the trust. George III is the beneficiary in our previous example.

What are the most common uses of trusts?

There are many uses for trusts in Tennessee. The following are some of the more popular uses of trusts.

Revocable Living Trust

While the revocable living trust has been a popular estate planning tool around the United States for decades, its popularity in Tennessee has intensified in recent years. Generally, there are three reasons why the revocable living trust is a popular estate planning tool.

1. The properly funded living trust avoids attorney costs and court costs involved in settling your estate through the court-supervised Tennessee Probate;
2. Distributing assets after death to beneficiaries of a living trust is faster than distributing assets to heirs in a Tennessee Probate; and
3. A Tennessee Probate requires a detailed public listing of all your assets when you die. A living trust can be settled without the necessity of a public detailed listing of your assets.

What is a Revocable Living Trust?

Example: Charlene has three children. Charlene went through a difficult and lengthy Probate when her father died, and she wants to make sure that her children do not have to go through a similar process when she dies. Charlene sets up a revocable living trust, naming her three children as equal beneficiaries at her death. Charlene names herself as the initial trustee, and she names her daughter, Karen, as the successor trustee to be in charge when Charlene dies. Charlene reserves the right to change or revoke her trust at any time. Charlene transfers her real estate and her investments to her trust. When Charlene dies, Karen immediately disburses the investments and the real estate equally to Charlene's three children. No Probate was necessary because no assets were titled in Charlene's name which would require Probate court orders to transfer.

The Revocable Living Trust is used primarily as a Probate avoidance tool **(but there are many other uses too)**! If your assets are titled in your name when you die, your assets titled in your name will be frozen, and your family will have to go through a Probate and obtain court orders which order banks, financial institutions, and others to transfer your assets to your heirs. If your assets are titled in the name of your trust, your successor trustee will have immediate access to your assets and will be able to sell or distribute them to your beneficiaries that you named in your trust – no Probate is necessary to transfer these assets after your death.

Avoiding the Tennessee Probate

Many years ago, it was determined that the courts must oversee the distribution of a deceased person's assets to their heirs. In Tennessee, this court-supervised procedure is known as a "Probate."

Having the courts oversee the distribution of your estate to your heirs may not be the most efficient way for your family to settle your estate. Courts are well-known for having inherent delays and costs.

In most Living Trust arrangements, the parents are the Settlors, the initial Trustees, and the first income beneficiaries. A successor trustee or co-trustees are designated (often an adult child or children), and the children are designated as the principal beneficiaries – to receive the trust assets after the parents die. When the parents die, trust assets are not frozen and trust assets do not have to go through a court-supervised Probate procedure to be transferred. The trust instrument and trust law permit the successor trustee to distribute the trust assets in accordance with the instructions provided in the trust instrument.

What Savings Result From Avoiding a Probate?

That's a difficult question to answer. There is no standard for Probate costs in Tennessee. Probate costs always include court filing costs and attorney fees. There is no standard for attorney fees.

You can ask five different attorneys how they charge for a Probate and you may get five completely different answers. Where families get taken advantage of is when there is not a crystal-clear discussion regarding attorney fees at the outset.

I met with a woman once who, after her husband died, she went to see an attorney that she went to church with and asked him to handle her husband's Probate. They did not discuss fees. When he finished months later, he sent her a bill for $35,000. She said she does not speak to this attorney any more even though they go to the same church.

Tip: Always work with an attorney who provides you with a fixed fee quote – in writing – prior to commencing the legal services.

Bottom line: Let's assume that completing the Tennessee Probates – first after the husband dies, and again after the wife dies, costs $15,000 after each death.

This means that – if the Probate is avoided by using a revocable living trust – the family will save around $30,000.

More Savings If You Own Out-Of-State Real Estate

If you live in Tennessee and you own real estate in another state when you die, your heirs will have to go through a Probate in Tennessee, and they will also have to go through an "ancillary probate" in the other state. The Tennessee Probate transfers your Tennessee real estate and all other non-real estate assets. The Tennessee Probate does not transfer out-of-state real estate. A probate in that other state must occur to transfer that property to your heirs.

If you have a revocable living trust and you transfer your out-of-state real estate to your trust, this ancillary probate will be avoided.

Living Trust Settlement Faster than Probate

Example: Dad died owning two investment accounts. Each account held about $300,000 of investments. One account was titled in Dad's name. The other account was titled in the name of Dad's revocable living trust. After Dad died, the successor trustee of Dad's trust was given immediate access to the trust account and within one week was able to distribute the account to Dad's beneficiaries. The account that was titled in Dad's name, however, had to go through a Probate with the family incurring thousands in costs and it is taking several months for the Probate paperwork to make its way through the judge's office, the processing department at the courthouse, and the legal department of the institution which held Dad's account.

Let's look at a typical example of the mechanics of a revocable living trust and how it should work in Tennessee. Let's say you are married and you have three children. You feel it would be in you and your family's best interest to form a revocable living trust. Here's what happens next.

You work with an attorney (hopefully an attorney knowledgeable in living trusts and hopefully someone you have good rapport with) to prepare your revocable living trust. A complete revocable living trust estate plan will also include a last will and testament for you and your spouse, a durable power of attorney, a health care power of attorney, and a living will, and perhaps legal documents transferring your Tennessee real estate to your trust. Once all these documents are prepared you sign them.

Next, you must fund the trust. You will avoid probate only if all of your "probate assets" have been transferred to your trust before your death. Documents are prepared and signed whereby you and your spouse transfer title to your home, other real estate, stock, bonds, brokerage accounts and mineral interests to your trust.

Which assets do not need to be transferred to your revocable living trust?

It's likely that you own assets that do not need to be transferred to your trust – and probate can still be avoided.

IRAs, 401(k) accounts, annuities and life insurance have designated beneficiaries. By their nature, these types of accounts avoid probate. As long as you properly designate beneficiaries, these assets will not be part of your "probate estate" when you die, and your beneficiaries will not be required to go through a Probate when you die to obtain ownership of these funds.

Example. Dad owns an IRA. He names Mom as the primary beneficiary, and he names his two children as equal contingent beneficiaries. When Dad dies, Mom obtains a death certificate and presents it to the financial institution where Dad's IRA is held. Dad's IRA will be transferred into Mom's IRA without a court proceeding.

Do you need to transfer your bank accounts to your revocable living trust?

There are two schools of thought on whether you should transfer your bank accounts to your revocable living trust. Many bank clerks and even financial advisors that I speak with will tell me that their clients should just name the accounts jointly, and then name the adult children as co-owners or transfer-on-death (TOD) beneficiaries. After all, they tell me, the accounts will avoid probate this way.

Are they right? Sure, if the ultimate goal is to avoid probate. However, many clients that we work with have many other goals for their family other than probate avoidance.

When I speak with clients I tell them they should title their assets jointly as husband and wife ONLY if they both agree with ALL of the following:

- **Want All Assets Outright to the Surviving Spouse**
- **No Estate Tax Issues**
- **It Is the First Marriage, and All Children Are From That Marriage**
- **Both Spouses Agree as to the Ultimate Distribution of the Estate**
- **They Are Not Worried About Remarriage of the Surviving Spouse and All Assets Ending Up with the New Spouse and His or Her Family**

When you name accounts jointly as husband and wife, followed by naming your children as TOD beneficiaries, the following problems can result:

- **Circumvent the Wishes in the Will or Trust**
- **Foul Up Estate and Gift Tax Planning**
- **Unintentionally Disinherit Beneficiaries**
- **Provide No Liquid Assets to Pay for Final Funeral Expenses or Ongoing Expenses After Death**

What is the Biggest Problem with TOD Beneficiaries on Accounts?

What we find to be the biggest problem with TOD accounts are all the problems that result after death. When you name an executor in your Last Will and Testament, that executor sits in a fiduciary capacity and has a duty to pay all of your legally enforceable debts. If you dispose of your estate by TOD accounts and there are no liquid assets to pay your legal enforceable debts, your executory may feel compelled not to pay them. NO!!! Your executor can be held personally liable for these types of actions and for violating their fiduciary duty to the estate!

What About Just Naming Adult Children on the Accounts as Co-Owners?

This is tempting for many families, but also can result in more problems than it is worth. The following is a list of the major problems that can result by naming adult children as co-owners on any asset just to avoid probate:

- **Subjects the Account to the Creditor/Predator Problems of the Joint Owner**
- **Lose the Estate Tax Exemption of Husband/Wife**
- **May Not Avoid Probate**
- **Creates a Taxable Gift**
- **Lose the Step Up in Cost Basis at Death**
- **Circumvents the Wishes in the Will or Trust**

What happens to a revocable living trust when the first spouse dies?

How your trust works after the first spouse dies (if you are married and you and your spouse set up a trust) depends on how you set up the trust in the first place.

You could have set up your trust so that the entire trust is now controlled by the surviving spouse, and the surviving spouse can revoke or change any provisions of the entire trust.

Or, you could have set up your trust so that when one spouse dies, that spouse's share of the trust becomes irrevocable. This protects the beneficiaries of the first spouse to die.

Example. Dad dies after Dad and Mom created a revocable living trust. Dad has three of his own children from his first marriage. Mom has two children from a prior marriage. When Dad dies, their joint trust assets total $1 million in value. Dad's part of the trust ($500,000) becomes irrevocable. Mom can do whatever she wants with her half, and she continues to be the trustee of Dad's half. She can spend Dad's half if she needs it, but whatever is left in Dad's half when Mom later dies must go to Dad's three children. Also, the assets in the "Dad Trust" will not be included in Mom's estate for federal estate tax purposes.

When the surviving spouse dies, the successor trustee (likely your adult child) will be responsible for following the instructions you gave them in the trust for perhaps terminating the trust and distributing trust assets to the beneficiaries. If the surviving spouse, at the time of his or her death, owns shares of stock, real estate, or other "probate assets" in his or name (as opposed to owned by the trust) a Probate will be necessary to transfer the asset out of the decedent's name to the trust pursuant to the "pour-over Will." If the trust was funded properly the "pour-over Will" may never need to be used.

The following are important about revocable living trusts in Tennessee:

(1) Taxes. Typically, you and your family will pay no more or less taxes if you have a revocable living trust. All trust income flows through the trust to you personally. The trust pays no tax;
(2) Funding. It is important that you transfer assets to your trust during your lifetime. Typical assets you must transfer to your trust include your real estate (both in Tennessee and out of state, mineral interests, stocks, bonds and mutual funds;
(3) Assets You Can Keep in Your Name. Keep your IRAs, 401(k)s, annuities and life insurance in your name, but designate beneficiaries on a designated beneficiary form.
(4) Save Time and Estate Settlement Costs. The Probate/probate procedure in the State of Tennessee takes months if not years. Using a revocable living trust to avoid a Tennessee Probate can save your loved ones the cost, stress and inherent delays involved in a Probate.
(5) Protect Your Children's Inheritance. Revocable living trusts can be used to protect your children's inheritance from divorcing spouses, creditors, lawsuits, and other predators. This can ensure that their inheritance and the wealth you spent a lifetime to accumulate remain in the family.
(6) Work with an expert. The trust laws change annually. Make sure you work with a Tennessee attorney that is familiar with the nuances of the Tennessee trust and Probate law.

The following people typically are eager to establish a revocable living trust in Tennessee:

(1) You have been through a difficult Tennessee Probate or an out of state probate in the past – perhaps when your parents died – and you don't want to put your loved ones through the same thing.
(2) Perhaps your parents had a revocable living trust when they died, and you saw how easy it was to settle their estate.
(3) You don't want your spouse or children to go through an expensive, timely, stressful, and public court process when you die.
(4) You live in Tennessee, but you own real estate in other states. A revocable living trust will avoid the Tennessee Probate and the ancillary probate in those other states where you own real estate;
(5) You want someone else to manage your assets for you. You can establish your revocable living trust and name someone else as your trustee (such as a trusted friend, advisor, relative, or a corporate trustee) so that they can handle your investments, bank accounts, and also handle purchases and sales of assets on your behalf.
(6) You want to protect your children's inheritance from divorcing spouses, creditor claims, lawsuits, and other predators.
(7) You don't want your estate to be fouled up due to beneficiary designations, transfer-on-death designations, and jointly owned accounts being incomplete or inaccurate when compared to your will.
(8) You are in a second marriage and want to ensure that your children from your first marriage receive your assets after you and your second spouse pass away.
(9) You have an IRA and want to create a "private pension" for your children.

While the determination of whether you should have a Will-based estate plan or a trust-based estate plan depends on your circumstances and objectives, it is fair to state that your Will based plan is easy to set up but requires court supervision of your estate settlement, while a trust based plan requires you to transfer assets to your trust during your lifetime but avoids court interference when you die.

Other Uses For Trusts

Trusts for Minors

If you have minor children, or if you plan on leaving a bequest to your young grandchildren, you should consider a trust.

In Tennessee, if a minor (a child under the age of 18) inherits in his or her own name, then a court-supervised guardianship proceeding is necessary. The court will appoint a tutor to oversee the minor's inheritance, and any payments to or on behalf of the minor must be approved in advance by the court. This is an expensive and cumbersome proceeding.

If you have minor children, you should designate in your Will that any inheritance your children receive will be placed in trust so that the trustee that you name can manage the assets and use it for the right reasons without having to get the courts involved.

If you would like to leave a bequest to your grandchildren, you should do the same, particularly if your grandchildren are young and unable to manage an inheritance for themselves.

Example: Grandma and Grandpa want to leave $50,000 to each of their five grandchildren (who currently range in age from 15 down to 2). If the grandchildren inherit this money while they are minors, a guardianship proceeding will be required in which the court will appoint a tutor to oversee the funds. If the money needs to be used prior to the grandchild's 18th birthday, a judge must approve the expenditure. At the grandchild's 18th birthday, the guardian must turn the funds over to the grandchild.

A better alternative is to provide in the revocable living trust or last will and testament of Grandma and Grandpa that these funds for the grandchildren will be placed in trust after the death of Grandma and Grandpa. Perhaps each grandchild's parents could be the trustees of the trust, and Grandma and Grandpa would authorize the trustees to use the funds for the grandchild's health, education and welfare. Perhaps Grandma and Grandpa could also provide that whatever funds remained in the trust when the grandchild reached the age of 25 (or some other age when it is more likely that the grandchild would have matured) would be turned over to the grandchild.

Trusts to avoid estate taxes

The federal estate tax exemption has increased in recent years from $600,000 to $11,200,000. Less than 1% of families are subject to the federal estate tax. However, for those families that are subject to this tax, it can be devastating. Tennessee's inheritance tax has been phased out. As of January 1, 2016, the Tennessee Inheritance Tax has been effectively repealed. Although, this does not guarantee that the Tennessee Legislature will vote in future years to bring back the inheritance tax. Therefore, all Tennessee families need to continually review their estate plan to ensure that law changes have not made their estate plan obsolete.

Many individuals and couples who are facing a federal estate tax at their deaths transfer assets to an irrevocable trust during their lifetime to remove those assets from their estate. Each person can transfer $15,000 each year either to an individual or to a trust for the benefit of that individual.

Example: Mom and Dad have a combined estate of $24,000,000. Even with a properly drafted will or revocable living trust, there will be an estate tax bill due to the IRS of about $640,000 after the death of the surviving spouse. They have three children and seven grandchildren. Since both Mom and Dad can transfer $15,000 to an unlimited number of people each year tax free, they decide to create an irrevocable trust for the benefit of their children and grandchildren, and they transfer assets valued at $150,000 each year to the trust. They name their trusting son as the trustee of the trust. It will be his job to manage the trust assets until Mom and Dad die, and then distribute the trust assets in accordance with the instructions given him by the trust instrument.

Special Needs Trusts

Individuals with certain disabilities can receive cash benefits and medical coverage from various government programs. In order to qualify for these benefits, the individual's income and resources must not exceed certain levels.

If a parent leaves a bequest to a special needs child, the inherited assets may preclude the child from receiving the benefits. The government, however, has established rules to allow assets to be held in trust for the benefit of a special needs child, preserving the government benefits, as long as certain parameters are met.

These trusts, called Special Needs Trusts, preserve government benefit eligibility and leave assets that will meet certain needs of a special needs individual. Special Needs Trusts are typically designed so that the trust assets can be used to supplement, not supplant, government benefits. Trust assets are typically distributed to third parties to pay for items other than the food and shelter of the disabled individual.

Trusts for Married Couples

Trusts are commonly used by married couples. Many married couples would like for the surviving spouse to benefit from the assets accumulated during the lifetime of the couple, but married people don't like the idea of all of their assets going to the surviving spouse's "new" spouse.

Example: Ted and Angela have $1,000,000 in assets. Ted has two children from a prior marriage. Angela has one child from her prior marriage. Ted wants Angela to have access to their estate if he dies first, but he fears that it will all be left to Angela's "new" husband if Angela marries after Ted's death. Or, if Angela does not remarry, she might leave the entire estate to her one child when she dies—to the exclusion of Ted's children. So, Ted establishes a trust (this trust can be in his revocable living trust, or in his Last Will, or it can be a standalone trust) so that Ted's assets go to the trust when Ted dies. Angela will be able to use the trust property after Ted dies for her health, education, maintenance and support. When Angela dies, the remaining trust assets will revert back to Ted's children.

Charitable Trusts

You can donate assets to charity during your lifetime. You can also leave assets to a charity when you die by naming them in your Will or on your beneficiary designation forms.

If you donate assets to a charity while you are alive, you may benefit from a charitable income tax deduction, but you will receive no further financial benefit.

If you leave assets to a charity when you die, your estate is entitled to a charitable estate tax deduction, but you get no tax or other financial benefits while you are alive.

If you create a charitable remainder trust during your lifetime and transfer assets to it, you will receive a charitable income tax deduction when you transfer assets to the trust, and the trust, within certain parameters, will pay you an income for the rest of your lifetime or for a certain period of years. Since the trust is a "charitable" trust, it can sell the assets that you transferred to it without incurring any capital gains tax on the appreciation. At your death or at the end of a term, the assets are transferred to your favorite charity or charities.

Summary of Trusts in Tennessee

While trusts can be confusing at first to the lay person, trusts can be a valuable estate planning tool. Common types of trusts in Tennessee include:

- Revocable living trusts. Becoming increasingly popular for Tennessee residents because it allows families to avoid the court-supervised Probate procedure at death and provides for a faster and less-costly estate settlement at death. A revocable living trust can be extra beneficial if you own real estate in other states allowing your family to avoid multiple probates.
- Trusts for minors. If there's a chance your minor child or minor grandchild will inherit assets from you, then you need to make sure those assets will be placed in trust so the courts won't need to supervise the minor's assets and so that the minor will be protected from squandering the assets when he or she reaches the age of 18.

- Trusts to avoid estate tax. Not as popular now since the estate tax exemption has increased from $600,000 to $11,200,000, but if estate taxes are likely, you need to consider these irrevocable trusts.
- Special Needs Trust. If you have a child with special needs, make sure any inheritance you leave that child is placed in a Special Needs Trust. This will help preserve government benefits that benefit the child.
- Trusts for Married Couples. A way to make your assets available for your spouse after you die, but when your spouse later dies, the trust assets will revert back to your heirs, not your spouse's heirs.
- Charitable Trust. A vehicle which allows you to transfer appreciated assets to a charity, have them sold with no tax consequences, receive an income off those assets for your lifetime, and at your death the remaining trust assets are passed along to your favorite charity or charities.
- Protecting the Children's Inheritance.
- Stand Alone Retirement Trust. A vehicle which preserves your retirement account upon your death, forces your children to only withdraw what is required each year under the tax laws, protects this inheritance from creditors, divorcing spouses, lawsuits, and other predators, while creating a "private pension" for your children.

Medicaid Planning

Avoid Nursing Home Poverty

What is Medicaid?

Most of the nursing home residents in Tennessee have their stay paid for, all or in part, by Medicaid. The cost of a monthly nursing home stay in Tennessee can vary from city to city but most nursing homes cost $6,000 or more each month. If a married couple is in a nursing home, and they are paying for their care and their medicines and other necessary living expenses, they could be paying out more than $10,000 each month.

An extended nursing home stay can wipe out a family's entire life savings in a few months or a few short years. This is why so many people are interested in finding out how they can qualify for Medicaid, which pays this nursing home cost.

In order to qualify for Medicaid, you must meet Medicaid's definition of "poor." There are other requirements as well – you must be at least 65 years old, blind or disabled, and your income and assets must be limited.

Title XIX of the Social Security Act, enacted by the Social Security Amendments of 1965, provided for grants to states to implement the Medicaid Program. Medicaid is a federal-state entitlement program that pays for medical services on behalf of low-income eligible persons. Medicaid is financed from federal and state funds.

The vast majority of Medicaid spending for long-term care is on nursing homes. However, Medicaid is available to people who need the type of medical care available in a nursing home setting but who can be treated effectively at home or in the community without being placed in a nursing home. However, Medicaid's resources are limited and there are long waiting lists to receive these services outside of the nursing home.

Medicaid is Not Medicare!

Even though the names sound similar, the programs are very different. Medicare is the health insurance that most people age 65 and older have in the United States. Medicare is designed to cover the expenses that health insurance typically covers, such as doctor's visits, hospital stays, surgery, and lab tests.

How Does a Single Person (Unmarried) Become Eligible for Medicaid?

To be eligible for Medicaid, you must pass an income test and an asset test. Let's look first at the income test.

In Tennessee, a Medicaid applicant can have no more than $2,250 of income per month and qualify for Medicaid. But what if your income is $2,300 and the cost of care is $5,000 per month? In Tennessee, you generally qualify for Medicaid from an income point of view if your income is less than your cost of care.

Personal Needs Allowance. The amount of money from your income that you are allowed to keep each month is called the personal needs allowance. Tennessee's personal needs allowance is currently $50. All of your other income, with a few exceptions such as health insurance premiums, must be paid to the nursing home. The nursing home then bills Tennessee's Medicaid program for the shortfall.

Asset test. A single applicant can have no more than $2,000 of "countable" assets. Countable assets include cash, bank accounts, certificates of deposit, IRAs, 401(k) accounts, stocks, bonds, lump sum annuities, cash value in life insurance policies, real estate that is not your home, business interests, and other assets that can be converted to cash. Interests in a Probate are countable even if the Probate has not been opened or the inheritance is refused.

What assets don't count for Medicaid?

Countable assets, like the ones described above, are assets that count in terms of qualifying for Medicaid. Noncountable assets, also known as excludable assets, do not count. Owning noncountable assets will not affect your Medicaid eligibility.

By far the biggest noncountable asset that most of us own is our home property. In Tennessee, the home property is property in which you have an ownership interest and that serves as your primary residence. It includes the house or lot which is the usual residence, all contiguous property, and any other buildings on the home property. Property is contiguous to the residence if it is touching the residential property (even corner to corner) and is not separated by property owned by others. Property separated by a public right of way, such as a road, is considered contiguous.

Do not rely on Homestead Exemption status for determining home property for Medicaid eligibility purposes.

Your home property will be excluded if you are living in your home, or if you are away from your home because of a medical condition, and you are keeping your home available, and you intend to use it as your home when your condition permits and it has an equity value of less than $572,000. Your home property is also excluded when you are away from your home and your spouse and/or dependent relative lives there.

Your home property is no longer excludable if offered for sale based on your lack of intent to return. A Nursing Facility resident generally cannot establish a new home property while residing in a facility since you would have never lived there and the new residence would not meet the definition of home property.

The value of your home property that is in another state outside of Tennessee is generally a countable asset.

Household goods and personal effects. You can exclude the following items, regardless of value: one wedding ring and one engagement ring per individual, along with prosthetic devices, wheelchairs, hospital beds, dialysis machines and other items required by a person's physical condition if they are not used extensively and primarily by the other members of your household.

A general exclusion of up to $2,000 applies to the total equity value of household goods and personal effects other than those excluded regardless of value.

Vehicles. One vehicle per household is excluded, regardless of its value, if anyone in the Medicaid applicant's household uses it for transportation. Medicaid assumes that your vehicle is used for transportation unless there is evidence to the contrary. This exclusion even applies to temporarily inoperable vehicles which are expected to be repaired and used for transportation within the next 12 months.

If you own more than one vehicle, the exclusion applies to the car with the greater equity value, regardless of which car is actually used. The equity value of all other vehicles, including inoperable vehicles and antique cars is counted. Medicaid uses the NADA "Blue Book" trade-in value at www.nadaguides.com.

Burial Contracts, Burial Funds, and Burial Spaces. A burial contract is countable if it is revocable or salable, and conditions for its liquidation do not present a significant hardship. However, any portion of the burial contract that clearly represents the purchase of burial space may be excludable, and some or all of the remaining value may be excludable as burial funds. A burial contract is not countable if it cannot be revoked and cannot be sold without significant hardship

Burial Funds. Funds set aside for the burial expenses of the Medicaid applicant and his/her spouse may be excluded if those funds are clearly designated for your or your spouse's burial expenses. A maximum exclusion of up to $10,000 each in funds set aside is allowed for you and also your spouse. This amount is reduced by the face value of your burial insurance which has no cash value.

Burial Spaces. A fully paid burial space or agreement which represents the purchase of a burial space held for your burial, your spouse's burial, or the burial of immediate family is excluded regardless of value.

What are the rules if you are married?

If you are married and receiving Medicaid benefits, some of your income can be paid to support your spouse.

The income and asset tests are significantly different if one spouse is in the nursing (the "institutionalized spouse") and the other spouse stays at home or in the community (the "community spouse").

One rule that is rarely understood is that the income of the community spouse is never considered in determining eligibility for an institutionalized spouse.

Example. Mary Smith is applying for Medicaid. Her husband receives $4,000 of monthly pension and social security income. Mary receives $600 of monthly social security income. Bill's $4,000 of monthly income is not considered in determining Mary's Medicaid eligibility.

A spouse has full ownership of income paid to his name. A spouse has half ownership of income paid in the names of both spouses. And a spouse has pro rata ownership of income paid in the names of either one or both spouses and another individual.

The amount of the institutionalized spouse's income that a community spouse can keep to live on is called the Maintenance Needs Allowance. Here's how it's calculated. Let's say Bill Smith has $2,000 of monthly income and his wife Mary has $1,000 of monthly income. Bill is in the nursing home and Mary wants to know if she can keep any of Bill's income.

We start by determining Bill's income ($4,100) and we deduct his personal needs allowance ($38) and we subtract his health insurance premiums ($150). The community spouse's liability totals $3,912.

Next, we subtract the spouse's monthly income ($1,000) from the Spouse's Maintenance Needs Allowance ($3,090.00 for the year 2018) to determine how much of Bill's income that Mary can keep. In this case, Mary can keep $2,090.00 of Bill's monthly income, and the remaining $1,822 ($3,912 minus $2,090) is paid to the nursing home.

What's the Asset Rule if You Are Married?

If you are single, in order for you to qualify for Medicaid you must have no more than $2,000 of countable assets.

The asset rules are very different for married couples when one spouse is in the nursing home (institutionalized spouse) and one spouse is at home (community spouse).

In Tennessee, a married couple can have as much as $115,920 (for 2017) in countable assets and the institutionalized spouse can qualify for Medicaid. This amount is called the Spousal Impoverishment-Maintenance Needs and Resource Standards. It's defined as the maximum amount of the couple's combined countable resources that may be allocated to the community spouse.

A married couple's countable assets are defined as including the community spouse's assets, the institutionalized spouse's assets, and the couple's shared assets.

Example. In addition to their home and car, Bill and Mary Smith have countable assets totaling $175,000. Bill is in the nursing home. We know he can keep $2,000. Mary can keep $115,920. Bill will not qualify for Medicaid at this time because they have $57,080 "too much" in countable assets.

However, if when Bill applied for Medicaid, he and Mary had countable assets totaling $90,000, he would qualify for Medicaid. Their total countable assets were less than $115,920. However, the assets that are allocated to the institutionalized spouse that are in excess of $2,000 must be transferred to the community spouse in order for Bill to remain eligible.

Estate Recovery – Medicaid Can Take Your Home After You Die

The federal government has required the State of Tennessee (and all other states) to establish an estate recovery program. As a result, state Medicaid office has established an estate recovery program for the purpose of recovering payments made to nursing homes on behalf of Medicaid recipients.

At the time that a Tennessee resident applies for Medicaid, the applicant shall be informed that federal law and regulations mandate estate recovery action by the state and that payments made by Medicaid may be subject to estate recovery.

Recovery can be made only after the death of the patient and his or her spouse. After the patient dies, Medicaid will serve a notice on the family or heirs of Medicaid's action.

Example. Bill Smith is in the nursing home and on Medicaid. His wife Mary lives in their home. Bill was eligible for Medicaid because their home was an exempt asset (for purposes of Medicaid eligibility) and their countable assets were less than $115,920. During Bill's stay in the nursing home, he spent

$150,000 of Medicaid's funds. After both Bill and Mary die, Medicaid can force the home to be sold to be reimbursed for the Medicaid funds they spent for Bill.

Penalties for Transfers

Mary Jones would qualify for Medicaid except that she has a bank account with $61,000. Mary decides to give her daughter, Jane, a gift of $60,000. After the gift, Mary has only $1,000. Does Mary now qualify for Medicaid? Not a chance.

When you apply for Medicaid, the application asks you to list any transfers or gifts that you have made to an individual or a trust in the last five years (or 60 months).

If a transfer is discovered during this 60 month look-back period, then the applicant is disqualified for Medicaid until the penalty period expires. The penalty period is determined by dividing the value of the transfer by the Average Monthly Cost to Private Patients of Nursing Facility Services. For 2017, Tennessee has determined that the average monthly cost of a nursing home stay is $4,567. So, if Mary made a transfer of $60,000, she would ineligible for Medicaid for 13.1 months ($60,000 transfer divided by $4,567 average nursing home cost).

When Does the Penalty Period Start?

The penalty period starts when the individual is in the nursing home, has less than $2,000 of countable resources, and is determined by Medicaid to be eligible except for the occurrence of the transfer.

By now, you probably realize that Tennessee's Medicaid rules are complex. So, let's take a look at some of the planning opportunities that are available.

Qualifying for Medicaid

Every Medicaid applicant's situation is unique. What may work for one person may not work for another. In developing a Medicaid plan, it's important that you work with someone knowledgeable in this complex area. The following are a few of the techniques often employed in assisting people in qualifying for Medicaid.

The reason that most people fail to qualify for Medicaid is that they have too many countable assets. So, most of the Medicaid Planning involves timely transfers of countable assets.

Owning Exempt Assets

Your house and your car are not countable. Certain burial contracts, burial funds and burial spaces are also not countable. By simply transferring countable assets (such as cash) into noncountable assets, you can qualify for Medicaid.

Example. Bill and Mary Smith have a home valued at $150,000. There is $35,000 left on their mortgage. They drive an old car worth $2,000, and they've made no funeral arrangements. They have CDs at the bank totaling $90,000, and their checking and savings accounts total $70,000. Mary is entering the nursing home while Bill will stay at home. Mary presently doesn't qualify for Medicaid because their countable assets exceed $115,920. Their countable assets actually total $160,000. But if they use $35,000 of their cash to pay off their mortgage, purchase a better car for $20,000, and use $12,000 to prepay their funerals, their countable assets will be reduced to $93,000 and Bill will qualify for Medicaid.

Making Gifts

Making gifts to qualify for Medicaid is one of the most misunderstood aspects of Medicaid Planning. If you take the correct action and structure your estate properly and stay out of the nursing home for five years after you set things up, you can protect your entire estate. If, however, you are like many who don't think about Medicaid eligibility planning until just before a family member goes in the nursing home, you can still take certain actions to protect roughly half of your countable resources.

Planning in Advance

If you transfer your countable resources out of your name at least five years before you go into a nursing home, you can protect all of your assets. But many people – justifiably so – don't want to put all of their assets into the names of their children. But you can keep some control over your assets by placing them into a particular type of irrevocable trust.

Who Should You Give Your Assets To?

Good question. Your options include your children, a trust, or a combination of the two.

Most families who engage in Medicaid Planning agree up front that the money that is taken out of the parents' names will be "set aside" in an account or accounts for the children. Children informally agree that they will not touch the money until after their parents die, and the children even informally agree that they will spend the money on the parents if necessary.

Unfortunately, things don't always work out as planned. Many times when parents give money to their children, the children end up spending it. Children have many reasons to spend it: they need it for a new truck or boat; they need to pay off credit card debt; they want a new home; they feel they deserve a vacation; they are influenced by their spouse; or, it's just too easy to spend it. The children could also lose the money by getting divorced, getting sued, or owing the IRS or other creditors. The children might also die before the parents and then the family is stuck trying to retrieve the money from the child's heirs.

Trusts and Medicaid Planning

What is a trust? A trust, as defined by the Tennessee Trust Code, is the relationship resulting from the transfer of title to property to a person to be administered by him as a fiduciary for the benefit of another.

For example, let's say John Nelson has four children. John wants to give his children a gift of $100,000, but he doesn't want them to spend it right away. John knows that if he gives $25,000 to each of his four children, at least three of them will spend it within a week or two. John feels that his daughter, Jenny, is responsible though and will act in accordance with John's wishes. So, John establishes the Nelson Family Trust and names Jenny as the trustee of the trust. John would like to continue getting the interest from the $100,000 so he names himself as the income beneficiary of the trust. John would like the principal (the $100,000) to be distributed to his children after John's death. Jenny goes to the bank and sets up the Nelson Family Trust bank account. Only Jenny has signature authority over this account because she is the sole trustee. John then transfers $100,000 of his money to this trust account. Jenny thereafter, in her capacity as trustee, manages this money for the rest of John's lifetime, seeing to it that John continues to receive the interest as the income beneficiary of the trust, and Jenny distributes the principal to the four children (the principal beneficiaries) after John's death.

Had John needed to move into a nursing home five years after setting this up, the $100,000 would not be considered a countable resource of John for Medicaid eligibility purposes.

Trusts are a popular tool in Medicaid Planning because, if established correctly, trusts can permit individuals and married couples to transfer assets out of their name, but retain control of the assets after they are transferred.

Many parents don't want to put their assets in their children's names because bad things can happen after the assets are transferred. Children might spend the assets, they might be influenced adversely by their spouses, children might get divorced and lose the assets, children may have creditor problems or problems with the IRS, children might get sued.

What If You Don't Have Five Years?

Many people don't even think about qualifying for Medicaid until their loved one is on the doorstep of the nursing home. These people can't wait five years to qualify – they face the prospects of depleting their life savings before the five years runs out.

Special techniques are available which allow you to save half of your countable resources if you are either already in the nursing home or you are going into the nursing home soon. These techniques require working with someone who really understands the ins and outs of transferring assets out of your name and returning assets back to you.

Every few years the Medicaid eligibility rules change making it harder and harder to protect your assets and qualify for Medicaid. With America's population aging, with the cost of care skyrocketing, and with less and less government funds available, it appears that it will be more important in the future to plan in advance for your potential long-term care nursing home stay.

Death and Taxes

Benjamin Franklin said it best

Everyone wants to avoid tax. When many people think about avoiding taxes, they think about avoiding income tax. Tennessee residents have to be concerned with several types of taxes when they are planning their estates. Some of the taxes that can be minimized include the Federal estate tax, the federal income tax, the capital gains tax, and the property tax.

Federal Estate Tax

The federal estate tax applies to estates of people who were residents in any of the 50 states. When it applies, it is significant. Essentially, when a person dies, we have to add up the fair market value (as determined by appraisal or otherwise) of everything the deceased owned – their house, cars, bank accounts, IRAs, 401(k)s, life insurance, stock, businesses they own, other real estate, and much more – and if the value of those assets exceed an exemption amount ($11,200,000 for deaths occurring in 2018) there may be federal estate tax due on the amount in excess of the exemption. The taxed portion will be taxed at a rate of about 40%.

For many years the estate tax exemption was $600,000 and many more estates were subject to the federal estate tax. As the exemption has increased to $11,200,000, it has decreased the number of families and estates subject to the tax.

Future of the Estate Tax

In 2018, the Jobs and Tax Cuts Act was passed into law by the President. Among the many sweeping changes included raising the Federal Estate Tax exemption amount to $11,200,000 for deaths occurring in 2018, and the estate tax rate is 40%.

Using Deceased Spouse's Unused Exclusion Amount

Under pre-2010 federal estate tax law, each spouse had an estate tax exemption. If the estate of the first spouse to die did not use his or her exemption, it would be lost and the surviving spouse could not use any of the exemption of the first spouse to die. This all changed in 2011, and the new tax act passed in January 2013, and later in 2018, kept portability in place

Now we have something called "portability." It allows the surviving spouse to increase his or her exemption amount by the amount of the unused exemption amount of the deceased spouse who died after 2010.

Example. Dad died in 2011 with an estate of $2,000,000. His estate was not large enough to fully utilize the $11,2000,000 exemption. Assuming an election was made by the Dad's executor, Mom's estate tax exemption will be $20.4 million ($11.2 million plus the $9.2 million that Dad's estate did not use).

Note that in order for the surviving spouse to increase his or her exemption amount, the executor of the deceased spouse's estate must make an election on the first spouse's timely filed estate tax return.

Calculating Federal Estate Tax

Essentially, when a person dies, the executor is responsible for determining the total value of the assets that the deceased owned on the date of his or her death. If the gross value of the assets exceeds the exemption amount, a federal estate tax return must be filed by the executor within nine months after the death.

The estate tax return is complicated to most people. If the deceased owned a business, a home or other real estate, appraisals must be obtained and attached to the return.

All of the investments and financial accounts must be reviewed to determine date of death values, and those values must be listed on the return.

The estate is entitled to deduct certain items before calculating the net estate. Common deductions include debts the deceased owed on the date of death, costs to administer the estate, bequests to a surviving spouse, and bequests to charitable organizations.

Example. Ralph died on January 15, 2020. He and his wife Theresa together owned a home worth $1,500,000, an investment account valued at $15,500,000, an office condominium worth $8,000,000, and miscellaneous other assets such as vehicles and bank accounts totaling $500,000. The total value of their combined estates were $25,500,000. Ralph's part was $13,250,000. Ralph's gross estate was $13,250,000. In Ralph's revocable living trust, he left his half of the home ($750,000) and condominium ($4,000,000) to his wife, Theresa, and he left everything else he owned to his children. Since his estate received a $4,750,000 deduction for the bequests to his surviving spouse, Ralph's net estate was valued at $8,500,000, and no federal estate tax was due.

How to Avoid Capital Gains Tax

Most people, when they think about avoiding taxes at death, think about how to avoid the federal estate tax. With the estate tax exemption at $11.2 million ($22.4 million for married couples), most families do not have to be concerned about paying federal estate tax.

The tax that often creeps up and bites people is the capital gains tax. Capital gains tax is paid when you sell an asset that has appreciated in value. For example, if you buy stock for $20,000 and later sell the stock for $100,000, you will have $80,000 of capital gain and you must pay tax on this gain.

Step Up in Basis

When you die, the basis of your assets will be "stepped up." Your heirs will get a new basis. Your heirs' basis will not be what you paid for the asset. Your heirs' basis will be the fair market value of the asset on the date that you died.

Example. Years ago, Jane bought stock in XYZ Company for $50,000. When Jane died many years later the stock was worth $400,000. Jane left this stock equally to her two children so that each child received stock that was worth $200,000. Since the basis of the stock was stepped up at death, each child will have a capital gains basis of $200,000 on their share of the stock. If they sell the stock for $200,000 shortly after Jane dies, they will incur no capital gains tax as a result of the sale.

Carry Over Basis

Note that this basis rule is different if you donate appreciated assets during your lifetime. The donee does not receive a step up in basis on stock that is given to him or her during the donor's lifetime. If, in the previous example, Jane had donated the stock to her two children just prior to Jane's death, the children would each have a basis of $25,000 on their share of the stock and they would have incurred significant capital gains tax on a subsequent sale of the stock – even if they waited until after Jane died to sell the stock.

For this reason, many people choose to "hold on" to their appreciated assets and let their heirs inherit them at the stepped-up basis, rather than donating appreciated assets to heirs during life causing donees to have a carry-over basis.

Bottom line on capital gains tax: Don't forget about potential capital gains tax when planning your estate – it often gets overlooked. Structuring your bequests the wrong way can cost your family hundreds of thousands (or more) of unnecessary capital gains tax.

There are many estate tax planning techniques that individuals and married couples can utilize. One of those techniques is to have the Will or trust set up properly to make certain that each married person's estate utilizes its maximum estate tax exemption. This allows married couples who die in 2018 to exempt $22,400,000 from the federal estate tax, because each estate is entitled to a $11,200,000 exemption – but you have to have things set up just right.

One common way married couples arrange their Trusts or Wills to avoid estate tax is to leave your estate in a QTIP trust for the benefit of your surviving spouse.

Avoiding Capital Gains Taxes for the Surviving Spouse with a Tennessee Community Property Trust

Another one of the many main worries that many Tennessee families have are "I don't want to lose all my wealth to Uncle Sam, the tax man, and I want to keep the government out of my private affairs." In addition, many Tennessee families that I speak with everyday have the same questions and concerns, "I have done well, I saved my money, and I invested conservatively, is there anything I can do to prevent having to pay these large capital gains income tax obligations?

Well, the good news is that in Tennessee the answer to this question is yes! Let me share with you an example of a client that I have been working with recently.

John and Barbara came into my office recently to have a discussion about their estate planning needs. You see, John and Barbara were now officially retired and so now it was time to think about what would happen to their family if they were no longer here. Specifically, John and Barbara felt it was time to finally have their wills completed. However, John and Barbara wanted to make things as simple as possible, avoid probate, and keep the government out of their private lives. Therefore, after having our initial discussion, John and Barbara realized that a revocable living trust may be the right way to set these things up for them.

However, after this initial conversation, as most conversations regarding estate planning usually go, the conversation turned to that of taxes. John and Barbara discussed with me that they had saved their money and invested conservatively all of their lives, and as a result, they had earned a sizeable amount of wealth. John and Barbara also told me that they had purchased some shares of stock about 35 years ago for $25,000 and now the shares of stock were worth $500,000. In addition, they informed me of a commercial building that they purchased for $300,000 approximately 40 years ago, and today the value of the property had increased to $1.5 million. John and Barbara discussed with me that at some point in the future they may need to sell this property but are concerned about the capital gains taxes that will be due when they sell this property.

I explained to John and Barbara that because of their wealth and tax bracket, they would be looking at a 20% capital gains tax rate. Therefore, if they sold the shares of stock today, they would realize a $475,000 gain and would have a tax obligation of $95,000. In addition, if they sold the commercial building they would realize a $1.2 million gain and would have a tax obligation of $240,000.

However, I explained to John and Barbara that there is a strategy that we could put in place today to reduce or even eliminate the looming capital gains taxes that would be due if or when they sell this property. I explained to John and Barbara that this is commonly referred to as the Tennessee Community Property Trust.

I explained to John and Barbara that how it works is that we will establish the John and Barbara Tennessee Community Property Trust. What this means is that all the property that you fund into this trust you are stating that you want to be treated as community property. Therefore, each of you will have a 50% ownership interest in each piece of property that is transferred into the trust. Then, after the first spouse passes away, the surviving spouse will become the full 100% owner of the trust assets and receive an immediate 100% step up in tax basis. What this means is that the commercial building will have a tax basis not of $300,000.00 but have a tax basis equal to the fair market value of what the property is valued at the date of death of the first spouse. In addition, the shares of stock would not have a $25,000 tax basis but would have a tax basis equal to the fair market value of what the property is valued at the date of death of the first spouse.

I explained to John and Barbara that what this means is that if after the first of you die, the survivor of you then sells the property, you will not realize a taxable gain and your capital gains tax consequences would be $0, a savings of $335,000!

As you can see from the story of John and Barbara, this type of planning strategy is extremely beneficial to those looking to avoid, or in some cases, even eliminate their looming capital gains tax consequences. For this reason, a Tennessee Community Property Trust can provide an excellent tax planning strategy.

In addition to the tax planning advantages, a Tennessee Community Property Trust keeps all the family assets private and out of probate. Just as John and Barbara stressed in the beginning of our conversation of their goal to keep things simple for their children after they were gone, a Tennessee Community Property Trust would also ensure that within days of their deaths all of the family assets would pass very quickly and easily to the surviving family members without any unnecessary delay and costs that would be associated with the probate court process, as well as exposing their private financial affairs to the public court system.

However, this type of planning is not just for those with multiple pieces of highly appreciated property, like John and Barbara. We also routinely set up this legal strategy for many other families, especially families in Williamson

County, Tennessee who have seen their personal residence increase in value at a high rate over the last 15 to 20 years.

Avoiding Estate Tax By Using QTIP Trusts

One way Tennessee married couples avoid or minimize federal estate tax is to provide that at the first spouse's death, the first spouse's assets remain in trust for the surviving spouse's lifetime. If the trust language provides that the surviving spouse is entitled to the income for the trust assets for the rest of her lifetime, then estate tax can be avoided at the first death.

QTIP stands for qualified terminable interest property. Other terms often used in conjunction with this type of trust include credit shelter trust, bypass trust, marital deduction trust, and QTIP trust. The terms of these trusts can be spelled out in the deceased's revocable living trust or in the deceased's last will and testament.

Gifts of $15,000

You may have heard that you can donate or give $15,000 (it used to be $14,000) to people each year without tax consequences. Many people are confused by this rule.

Typically no one pays income tax on a gift regardless of the value of the gift. A sizable gift, however, will have gift and estate tax consequences.

Example. Alice gives her daughter, Suzanne, $115,000 on February 1, 2019, to help Suzanne buy a home. This gift has no income tax effect on either Alice or her daughter, Suzanne. No tax is due as a result of the gift. The primary tax effect, however, is that Alice has made a $100,000 taxable gift. Gifts of $15,000 or less each calendar year need not be reported, but the fact that Alice gave $115,000 to Suzanne must be reported on a federal gift tax return (IRS Form 709), showing that Alice has used $100,000 of her $22,200,000 federal estate tax exemption. When Alice dies, her estate tax exemption (the amount exempt from federal estate tax) will be $11,100,000 instead of $11,200,000 because she used part of her estate tax exemption during her lifetime.

Many people who make gifts to others in excess of $15,000 in a calendar year do not have an estate that exceeds the applicable estate tax exemption of $11,200,000, so there really is no tax consequence at all to making large gifts other than the requirement of filing a federal gift tax return disclosing that the gift was made.

Tax Avoidance Techniques

Much has been said and written about avoiding federal estate tax and other taxes at death. The increase in the estate tax exemption to $11,200,000 will exclude many estates from being subject to the tax. However, for those families that are still subject to the estate tax, the following are popular estate tax planning tools:

1. Prepare Your Will or Trust Properly. For many people (especially married couples), having your Last Will and Testament or Revocable Living Trust conform to the estate tax laws will avoid estate tax completely. The law allows married couples who plan properly to exempt up to $22,400,000 from estate tax.
2. Annual gifts. You can give away $15,000 to as many people as you want, every year, to reduce your estate. If you have four children and eight grandchildren, you could (if you wanted to) reduce your taxable estate by $180,000 each year by making $15,000 gifts to each of them.
3. Use Life Insurance To Pay Estate Tax. This is a tool made popular by the life insurance industry. You are not reducing your estate tax by purchasing life insurance, but you are making gifts to children or others and the gifted money is used to purchase life insurance on your life that might pay the estate tax liability when you die.
4. Capital Gains Tax. Don't put appreciated assets in your kids' names without first considering the capital gains tax effect. Your heirs will enjoy the step-up in basis only if they inherit assets from you when you die, not if you donate assets to them during your lifetime.
5. Gifts and Bequests To Charity. What you leave to a qualified charity completely avoids estate tax. If Bill Gates and his wife leave their entire estate to their charitable foundation (or any other charity) no estate tax will be due at their deaths. There are many ways to donate or bequeath money to charity – some simple and some complex.

Summary on Avoiding Death Taxes in Tennessee

You can't avoid death, but you may be able to minimize or avoid death tax by:

- Making sure your estate utilizes its $11,200,000 exemption available for deaths occurring in 2018
- Properly setting up—if you are married—your Will or your Revocable Living Trust so there will be no tax upon the death of the first spouse regardless of the size of the estate
- Ensuring that your heirs receive a step-up in basis – not just when the first spouse dies but again when the surviving spouse dies
- Utilizing annual exclusion gifts of $15,000 during your lifetime to reduce your taxable estate at your death

The Looming Wealth Transfer Crisis – Preserving Family Wealth for Children and Grandchildren

$2.46 Trillion in Assets Held in IRAs!

A survey conducted in 2015 revealed that there is presently $2.46 Trillion in Assets held in IRAs at any one time across the United States. Next to a person's home, their IRA or other retirement account, is usually the second, if not the most valuable asset that a family will hold.

In addition, it is expected that an estimated $30 trillion in family wealth will transfer from baby boomers to the next generation over the next 20 years. We are in a unique period in our country's history with this vast transfer of wealth that is anticipated to occur. It is the failure to plan in this regard that can have devastating effects on your children and loved ones' future if the correct planning is not implemented.

This valuable Special Legal Report is designed to provide a summary and guide on how to protect your children's inheritance and create a lasting legacy through the use of Retirement Trusts.

The Transfer of Wealth and Designating a Beneficiary

Many people are familiar, generally, with how a retirement account works. Some of you may have an IRA, a Roth IRA, a 401(k), or a 403(b). There a variety of different types of retirement accounts. The general concept of a retirement account is that you contribute money during your working years, the money grows based on how it is invested and market conditions, and when you reach retirement age, the account is there for you to enjoy your retirement years.

As indicated above, nationwide there is an estimated $2.46 Trillion in assets in IRA accounts and other retirement accounts. A large percentage of these assets will transfer to the next generation over the next twenty years. However, whether the wealth transfer is a success or not will depend upon how beneficiaries are designated.

Most people, when they set up their retirement accounts, will name their spouse as the primary beneficiary and their children as contingent beneficiaries. ***However, is this appropriate from a tax savings perspective, an asset protection perspective, and a legacy planning perspective?*** This summary and guide will provide you with the information and tools to ensure that all three of these points are covered in your estate and legacy planning.

The *Clark v. Rameker* Case

In 2010, what we knew about asset protection given to Inherited IRAs completely changed with the decision of one court case! This case was the 2010 U.S. Supreme Court decision of *Clark v. Rameker*. In this case, Ms. Clark inherited an IRA from her mother in 2001 and filed for bankruptcy nine years later. The case made its way all the way to the United States Supreme Court who decided that Ms. Clark could not shield the account from her creditors. In their analysis, the Supreme Court made a distinction between IRAs that you inherit and ones that you set up and fund yourself. The Court's distinction is that IRAs that you set up and fund yourself receive creditor protection, but those that you inherit do not.

Therefore, as a result of one court case decision, Inherited IRAs are **not protected from creditors and this includes bankruptcy, lawsuits, and divorcing spouses!**

In Light of the *Clark* Case … How Should One Name a Beneficiary of Their IRA?

In order to provide asset protection, tax savings, and leaving a lasting legacy for your children and other heirs, when it comes to your IRA there are essentially three options when it comes to naming a beneficiary.

Naming Your Surviving Spouse as Primary Beneficiary

This is the most common way that most people name a beneficiary on their Retirement Account, and it is the most favorable from a tax savings perspective and an asset protection perspective. When you name a surviving spouse as a beneficiary of your IRA or other retirement account, your spouse will be able to withdraw the required minimum distributions (RMD) from that IRA based upon your surviving spouse's life expectance. In addition, and usually more favorable, the surviving spouse is allowed to treat the IRA as their own IRA and only withdraw the RMDs after age 70 and ½.

Example. John has an IRA worth $900,000 when he dies. His beneficiary leaves the IRA to his wife Jane as primary beneficiary. Jane visit the financial advisor who is managing the IRA and elects to treat the IRA as her own account. When Jane inherited the IRA, she was 68 years old. Therefore, Jane is allowed to contribute to the IRA and is not required to withdraw any RMDs from the IRA until she reaches age 70 and ½.

Therefore, from a tax savings perspective, this makes sense. In addition, from an asset protection perspective, this also makes sense. When a surviving spouse is able to treat the IRA account as their own, it is entitled to creditor protection just as an IRA does for the original IRA owner. The *Clark* case decision does not apply when the beneficiary is a surviving spouse.

Naming Your Children as Contingent Beneficiaries

When a person has a retirement account, the next logical choice is to name their children as contingent beneficiaries after their spouse. However, as I indicated above, is this the correct choice? ***The Average Inheritance Is Spent Within 17 Months After Death!*** This is a statistic published in the *Wall Street Steward Newsletter* in January 2013. With these troubling statistics, does it make sense to name your children as contingent beneficiaries? Maybe? Maybe not?

Let's look at children as contingent beneficiaries of retirement accounts and their options after death.

When a non-spouse inherits an IRA he or she is can be given two or three options depending upon the age of the parent when he or she passed away.

First, if the owner of the IRA was under the age of 70 and ½, the children beneficiaries can open their own Inherited IRA. In this case, they can stretch their distributions over the course of their lifetime based upon their own life expectancy. The second option is that the children can open an inherited IRA and withdraw their distributions over a five-year period. Their final option is to simply withdraw their share of the IRA as a lump sum distribution.

Obviously, the children stretching the IRA as an Inherited IRA over the course of their lifetime based upon their own life expectancy will be the most advantageous from a tax perspective. Unfortunately, the statistics show that this is rarely if ever the case as the average inheritance is spent within 17 months after death!

However, if the plan owner is over the age of 70 and ½ at the time of death, the adult children beneficiaries will only be given two options. Open an Inherited IRA and withdraw distributions over the course of their lifetime based upon their own life expectancy. The only remaining option in this scenario is to withdraw the IRA as a lump sum distribution.

It is important to note that when an adult child beneficiary opens an **Inherited IRA with the intention of withdrawing RMDs over the course of their lifetime, it must occur by December 31st of the year following the date of death. The adult children beneficiaries are not given the option to wait until they reach the age 70 and ½.**

A disadvantage to simply naming your children as direct contingent beneficiaries is that there is no asset protection when it comes to their Inherited IRA. This is the point made from the decision in the *Clark* case discussed above.

Naming Your Revocable Living Trust as Beneficiary

Sometimes, this type of legal strategy could make sense to protect your IRA. The revocable living trusts that we draft in our office contain necessary spendthrift language in order to protect the assets of the IRA from creditors, lawsuits, divorcing spouses, and other predators of the adult children beneficiaries. Therefore, in some instances, usually for IRAs and retirement accounts under $200,000, this will make sense.

However, there are some important planning aspects to consider and keep in mind when you name your Revocable Living Trust as the contingent beneficiary of your retirement account.

The first aspect has to do with how the trust is drafted. When you name a trust as a contingent beneficiary, the trust will base the RMDs on the oldest beneficiary named in the trust. However, this will only occur if the proper "see through" language is included in the living trust. This is language within the living trust that states that the IRA is to see through the trust to the individual beneficiary. Again, the distribution will be based upon the oldest beneficiary's age at the time of the IRA owner's death.

However, the downside with a Revocable Living Trust as contingent beneficiary of an IRA is that we are limited to the Conduit Trust provisions. What this means is that the RMDs that are required to be withdrawn from the IRA each year must go directly to the beneficiary, they are not allowed to accumulate inside the trust. As a result, the RMDs are not entitled to asset protection.

<u>Example</u>. John has three children, Joe, John Jr., and Sallie. John Jr. is 40, Joe is 37, and Sallie is 29. When John dies, his IRA is distributed to his Revocable Living Trust. However, each child must withdraw their RMD's by December 31st of the year following John's death, and is based upon John Jr's life expectancy, and not Joe and Sallie's life expectancy.

The disadvantage to this type of planning is that it effects the RMDs and therefore increases the amount of distributions each year. In the example above, had the RMDs been based upon Joe and Sallie's life expectancy, the RMDs would have been lower. Therefore, there are some tax consequences to this type of strategy.

When considering naming your Revocable Living Trust as the contingent beneficiary of your retirement account, we typically recommend this for smaller retirement accounts, typically $200,000 or less.

What about asset protection benefits? There is a level of asset protection benefits when you name a Revocable Living Trust as the contingent beneficiary of the retirement account. However, it will all depend upon the how robust the asset protection is that was written into the trust when it was originally established.

Some trusts will state that each beneficiary receives 1/3 at certain age, 1/3 at certain age, and the remaining 1/3 at a certain age. This strategy provides a level of asset protection as the assets that remain in trust are protected from creditors, divorcing spouses, lawsuits, and other predators. However, the moment that the assets are withdrawn, they lose their asset protection. Other trusts will state that each child receives a specific percentage or dollar amount each month. This can be difficult to enforce without a professional trust company as trustee and can be difficult to quantify based on the amount of assets in trust at the time of death. In addition, other trusts are simply titled as beneficiary controlled trusts when the beneficiary reaches a certain age (meaning the beneficiary is in charge and can withdraw how much or how little as they want from the trust).

For this reason, in our office we typically recommend a separate Beneficiary Controlled Trust, or a Beneficiary Protection Trust as we call them in our office, where the trust is self-directed by the beneficiary when the beneficiary reaches a certain age. This is where the beneficiary has access to their trust assets whenever he or she wants, and so long as they remain in trust, they receive protection for creditors, divorcing spouses, lawsuits, and other predators.

Naming a Standalone Retirement Trust as Beneficiary

This has become a very favorable legal strategy for those families who have IRAs and retirement accounts above $200,000. The Standalone Retirement Trust is a trust that is meant to hold only IRA or retirement assets upon the IRA or retirement owner's death. The Standalone Retirement Trust carries with it the highest level of tax savings and the highest level of asset protection for the adult children beneficiaries.

The Stretch Out. Above, we discussed the two or three options that adult children beneficiaries have when they inherit an IRA from a parent. However, we also discussed that the average inheritance is spent 17 months after death. Therefore, as owners of an IRA or retirement account that will be passed on to adult children after death, there is a high chance that the adult children beneficiaries may blow the stretch out.

This is where the Standalone Retirement Trust comes in play. This trust would be the contingent beneficiary of the IRA (or primary sole beneficiary if there is no surviving spouse). At death, the IRA is paid into the Trust. The required language is included within the Standalone Retirement Trust so that each beneficiary (if there is more than one beneficiary that would ultimately inherit from the IRA) to be considered the measuring life for determining RMDs (instead of using the oldest beneficiary's age). This gives the owner of the IRA the assurance that the stretch out will occur.

The Standalone Retirement Trust is also an Accumulation Trust. This is an added protection for the heirs and beneficiaries. As the RMD is withdrawn from the IRA each year based upon the beneficiary's life expectancy, the RMD accumulates inside the trust as opposed to being paid out directly to the named beneficiary. In this case, as opposed to naming the Revocable Living Trust as beneficiary of the IRA, the RMD is also entitled to creditor protection as well as the principal of the IRA continues to receive creditor protection.

Asset Protection. When this trust is used correctly, it offers a great deal of asset protection for the surviving children beneficiaries. The principal of the IRA trust is entitled to creditor protection, as well as the RMDs as they are not being paid directly to the beneficiary, but instead are being accumulated inside of the trust. This allows the IRA to grow and receive creditor protection.

How Difficult Is It For the Beneficiaries to Access? One question that I receive from clients who are researching this type of planning for their children is how difficult will this be for the beneficiary to access? Good question! It all depends on the terms of the trust and how restrictive the client wishes to make the control and receiving distributions. These trusts can be drafted so that the beneficiary has complete control as trustee of the Trust, these trusts can be drafted where the beneficiary has complete control only after a certain age and prior they are a co-trustee with another trusted individual, or these trusts can be drafted so that the beneficiary has no control but the trust describes a very specific criterion for the trustee to distribute assets from the trust to the beneficiary.

Ultimately, the creator of the Standalone IRA Trust can make accessing the funds as restrictive or as liberal as they want for their children. ***However, when making the decision on restrictiveness of access, always keep in mind that asset protection of the IRA and the RMDs only exist for as long as the assets remain in trust. Once the assets are removed from the trust they no longer are entitled to asset protection and become subject to the individual beneficiary's creditor claims.***

Protection for a Special Needs Beneficiary. Another aspect where IRA Trusts can provide a great deal of benefit is when there is a special needs beneficiary. As you may or may not realize, when there is a special needs adult child who is receiving public assistance benefits, the inheritance of a sum of money from their parents at death can result in the special needs adult child being denied their public assistance benefits. The Standalone IRA Trust can also be designed to preserve these benefits for the special needs adult child.

Dynasty Trusts and Sub-Trusts. Another added planning benefit of the Standalone IRA Trust is the ability to create sub-trusts and Dynasty Trusts. This is a concept known as a trust within a trust. A trust for a special needs beneficiary would be an example of a sub-trust that would be used inside of the Standalone IRA Trust. Another example would be a Dynasty Trust. This is a trust that is intended to continue indefinitely across multiple generations. Under Tennessee law, a trust can remain in effect for a total of 360 years. A family that has an IRA may desire to leave this asset to multiple generations so that multiple generations may benefit from the wealth that was created and saved through the IRA. A Dynasty Trust as a sub-trust would allow this trust to continue past the deaths of the currently named beneficiaries of the trust, thereby benefiting future generations.

A Case Study of Beneficiaries Receiving an IRA Inheritance

Let's take a look of a Case Study of two families. One engaged in proper IRA Trust Planning, and the other simply utilized their beneficiary designations with direct distributions to adult children.

Bill's Case. Bill has two children, John and Dan. Bill has listed both of his children as equal beneficiaries of his IRA. When Bill dies at age 65, the value of the IRA is $900,000. John takes a lump sum distribution of $450,000 and ends up paying taxes on the lump sum at the rate of 39.6%. Dan decides that he wants to treat the distribution as an inherited IRA and withdraws the balance over the next five years. Dan withdraws a large amount each year and pays significant taxes on each distribution. In addition, in year two, Dan is going through a divorce and ends up having to divide the Inherited IRA with his ex-spouse.

John's Case. John has two children, John Jr and Dan. Instead of listing his children as equal beneficiaries of his IRA, John establishes a Standalone Retirement Trust. At John's death, his $900,000 IRA is distributed and maintained in the form of an Inherited IRA inside of the Standalone Retirement Trust. As a result, John and Dan each end up taking RMD distributions during their lifetime which **total $2,916,313.85 each!** In addition, John Jr and Dan, for the most part, allow the RMDs to accumulate inside the Standalone Retirement Trust. Therefore, their share inside the Trust continued to rise and rise. Furthermore, when Dan got divorced several years later, he did not lose his inheritance as it was protected from divorcing spouses, creditors, lawsuits, and other predators by nature of the Standalone Retirement Trust. Now, both John Jr and Dan are in a position to leave an inheritance to their children as well. John's simple planning many years ago has resulted in him leaving a lasting legacy to not only his children, but his grandchildren.

Eight "Must Haves" To Look For in Your Estate Planning Attorney

1. Practices exclusively in the area of Estate Planning and Estate Settlement. The law changes every year. You and your family need someone who keeps up with these changes for you.
2. Serves clients for a fixed, reasonable cost. Don't get pushed around by lawyers who are anything less than crystal clear and 100% up-front regarding the fees required for the legal services to be rendered.
3. Works with a team of additional estate planning attorneys. Solo attorneys have no one they can collaborate with on your behalf. Benefit from a team of estate planning lawyers all of whom have your family's best interest in mind.
4. Is a member of national organizations of Estate Planning Attorneys and has been rewarded by multiple organizations for their work in the field of estate planning, estate settlement, and elder law.
5. Work with an attorney that **guarantees** professional and courteous service. Face it – lawyers in general have a well-deserved, awful reputation. Work with a firm that guarantees that if you don't get the service you expect, you get your payment back.
6. Work with an attorney who explains things in an easy-to-understand format. This will give you peace of mind that your greatest family concerns are addressed properly.
7. Use a law firm referred by – at least – hundreds of others. Go to their website and see if hundreds or thousands of others have had great things to say about the law firm you select. There is no greater way to evaluate a law firm than by seeing what **others** say about their services.
8. Work with an attorney who regularly speaks and writes about important estate planning topics. An attorney who routinely teaches others about estate planning is on top of, and well-versed, in addressing the estate protection needs of families like yours.