

Medi-Cal Estate Recovery: How To Protect Your Home (“House Trust”)

In previous editions of this newsletter, we introduced you to the concept of Medi-Cal “estate recovery,” that is, an unsecured claim made by Medi-Cal upon the death of a Medi-Cal recipient (and his or her spouse, if any) against the recipient’s estate for recovery of lifetime medical benefits paid to the recipient. Some people call it the “Medi-Cal lien.”

Several weeks ago, we told you that an outright gift of your home during your lifetime to your spouse and/or loved ones would avoid the Medi-Cal lien provided your transferee signs an affidavit stating that you can return home whenever you wish and it is medically feasible for you to do so. But what if you want more of an iron-clad guarantee of your right to return home or remain at home? Several other possibilities are available: the life estate and the irrevocable house trust.

A trust is simply one way of holding title to property, much like joint tenancy, community property, or tenants in common. Generally speaking, there are only two types of trusts: lifetime, or “living trusts,” as they are sometimes called, and testamentary. The former becomes effective immediately during one’s lifetime and the latter becomes effective only at one’s death. And, within the category of trusts called “living trusts,” there are two basic types: revocable and irrevocable. Revocable trusts, by definition, may be changed or terminated at will during the trustmaker’s lifetime, while irrevocable trusts may not.

For those unfamiliar with the concept of a trust, a trust is simply a contractual arrangement whereby one person (the trustmaker, settlor, grantor, trustor, or donor – all interchangeable terms) transfers title to property to another person (the trustee), along with a specific set of instructions on how to manage the property (called the trust agreement), for the benefit of one or more people known as beneficiaries.

In the case of an irrevocable house, designed to avoid the Medi-Cal lien, the homeowner creates the trust and deeds his/her home to his/her spouse and/or other loved ones, as trustee, with instructions on how to manage the home, including the right of the homeowner to live in the home for the rest of his/her lifetime or the right to return home when medically able to do so. At the homeowner’s death, title to the property is then delivered by the trustee to the spouse and/or other loved ones according to the terms of the trust agreement.

This type of transfer arrangement avoids the Medi-Cal lien, because the homeowner owns nothing at the time of his/her death: his/her right to live in the home expires upon his/her death. Technically speaking, title to the home was transferred during the homeowner’s lifetime to the trustee, and the homeowner merely retains a personal right to live in the home for life. The value of the life estate becomes zero at the homeowner’s death, and remember, estate recovery is limited to the lesser of nursing home benefits paid and the value of the property passing at death.

Having established the concept of an irrevocable trust as a viable asset protection technique, it’s also instructive to highlight other important advantages of a trust over an outright transfer.

First, a trust can be structured to permit the trustmaker to name new beneficiaries taking into account changed circumstances during the lifetime of the trustmaker. Compare this to an outright transfer where the transferee gets everything up front and there’s nothing left to give away. If the transferee gets sued, the home could be lost to creditor claims. If the beneficiary dies, the property could pass through probate to unintended heirs, like the son-in-law or daughter-in-law.

Second, a trust can be structured as a “grantor trust” (tax lingo) to preserve the capital gains exemption available upon sale of a primary residence just in case the house is later sold.

Third, a trust can be structured to avoid potential family conflicts by proper selection of a trustee and careful consideration given to structuring your beneficiary’s inheritance.

Fourth, a trust can be structured to ensure that any net rental income from the potential rental of the home is not figured into the Medi-Cal recipient's "share of cost" calculation.

Fifth, a trust can be structured to ensure that the ultimate heirs receive a stepped-up basis in the property for tax purposes at the death of the homeowner. When someone dies and leaves property, tax basis steps up to fair market value at the property owner's death. "Basis" is tax lingo for cost of acquisition plus cost of improvements less depreciation taken. The difference between selling price and basis at time of sale is capital gain, and capital gain is taxable. When someone receives property by way of a lifetime gift, their basis carries over from the transferor. If there was a substantial built-in gain in the property in the hands of the transferor, the built-in gain transfers to the transferee and is taxed upon later sale of the property by the transferee. If property has built-in gain, it is preferable for heirs to receive it by way of inheritance since basis adjusts to fair market value and all gain is effectively wiped out for tax purposes.

Sixth, a trust can be structured to give the trustmaker the right to demand sale of the property and reinvestment in replacement property, perhaps a retirement community, without the consent of anyone. Compare this to an outright transfer where there is always the risk of possible eviction.

Seventh, a trust is easier to enforce through the courts than an outright transfer.

Eighth, it is well established that transfer of a house to a house trust will not disqualify a Medi-Cal applicant or recipient from receipt of ongoing Medi-Cal benefits.

For these and many other reasons, an irrevocable house trust is preferable to an outright transfer with retained right of occupancy or a life estate.

If you, or someone you know, are receiving Medi-Cal benefits and would like to discuss ways to protect your home from future estate recovery claims, please give us a call. We can help!

Editor's Note: This article is one in a series of articles dedicated to the need for long-term care planning in a comprehensive estate plan and how to pay for nursing home care without going broke. This information is for general informational purposes only and does not constitute legal advice. Please do not rely on the limited information given here. Medicaid is a highly complex area of the law; it varies from state to state and even within a particular state. *Unfortunate and costly mistakes can be made if you do not know what you are doing.* Before taking any steps to protect assets, you are strongly urged to consult with an elder law attorney who is competent in this area of the law so that you will understand all of the ramifications of your actions, including but not limited to property, estate, gift, and income tax; financial and estate planning considerations; and even possible *criminal sanctions*.

If you need help in planning for long-term care as part of a comprehensive estate plan or finding the right nursing home or paying for it without going broke, please give us a call. We can help!

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