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Elder Law Planning After ATRA

An Interview with Bernard A. Krooks

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The arrival of ATRA represents an official new non-transfer tax paradigm in which planning is focused on capital gains, asset protection, state tax issues, income taxation, and Medicaid planning. All of these areas fall under the elder law umbrella.

"This is the perfect storm for elder law planning."

—Bernard A. Krooks

Elder law has unique rules, and planners must also be cognizant of the new ATRA context. Most fortuitously, one of the nation's foremost elder law practitioners has come to our assistance. Let's review the new planning dimensions with attorney Bernard A. Krooks.

Pilgrimage to Heckerling

Just as swallows migrate 6,000 miles to return to Capistrano each spring, estate planners are drawn to Florida every January for the Heckerling Institute on Estate Planning.

This year, only two weeks after the arrival of ATRA, more than 3,000 of the nation's most accomplished estate planning professionals descended on the Orlando Marriott for a Bacchanalian convocation filled with panel discussions, power point displays, sessions on sophisticated planning techniques, and nonstop examples of the rapier wit for which estate planners are known. (Example: Congress passed ATRA on December 32, 2012. Get it? An extra day in the month…perhaps you had to be there.)

This year's Heckerling Institute opened with a session on elder law in which attorney and CPA Bernard A. Krooks, a nationally known expert on elder law, special needs planning, and estate planning, was one of the speakers.

Mr. Krooks was kind enough to speak with us about the emergence of elder law as a primary planning area in the post-ATRA world, the impact of ATRA on existing trusts, and the role of trusts in ongoing estate planning. **Note:** A separate interview with Mr. Krooks about current planning strategies of elder law follows the main article.

The Planning Context of ATRA

With the enactment of the American Taxpayer Relief Act of 2012 (ATRA) in early January, the big picture of estate planning finally came into sharp focus.

For the past decade, and realistically even before that, the Federal Estate Tax was applicable to only a very small portion of the population. The emphasis of estate planning has been shifting away from classic transfer tax avoidance techniques, yet mainstream planners had to remain cognizant of the potential reversion to 2001 rates.

Even on the eve of ATRA, estate planning professionals could not risk losing the opportunity for clients to take advantage of the $5.12 million gift tax exemption before December 31, 2012, because there was no way to predict whether the gift tax exemption would expire permanently or not.

For those who were watching C-SPAN on New Year's Eve (and continued watching for about 22 hours thereafter), it was known that the estate and gift tax exemption was being extended, but it was not immediately clear what other provisions might have fallen over the fiscal cliff.

When the dust settled, it was clear that the estate and gift tax would remain unified. The $5 million estate and gift tax exemption level would not only remain but would continue to be indexed for inflation and would be $5.25 million for 2013. The portability of unused exemptions for spouses that was added in 2010 was made a permanent fixture of the Tax Code as well.

Interview with Bernard A. Krooks

Q: Are we entering the golden age of Elder Law planning, now that the Federal transfer tax is not going to impact the vast majority of estates?

A: I've done this for 28 years, and we have just hit the tip of the iceberg. For many years, elder law was the stepchild of estate planning that never got much attention. Now there are a number of major law firms that are dropping their estate practices. Last year, there were less than 4,000 estate tax returns that were subject to Federal estate taxation. And there were more than 3,000 planners at the Heckerling conference. That works out to a little more than one client apiece...and none to all the other planners throughout the United States.

Q: The statistic being noted recently is that there are 10,000 Americans turning 65 years of age every day. And if they aren't paying estate taxes, they need other types of planning.

A: There is clearly a shift towards the non-tax aspects of financial planning. It is just harder to earn a living doing estate planning without elder law. It is the perfect storm for elder law planning. Our nation is an aging society with people living longer, and they are demanding different services.

Q: Will estate planning attorneys simply switch their focus to elder law, assuming, of course, that they get training and take the time to become competent in elder law issues?

A: Consumers have to be very careful of estate lawyers moving outside their area and dabbling in elder law. They would be best served by a certified elder law attorney. The National Elder Law Foundation is the only entity certifying elder lawyers in the United States. A current list of certified elder law counsel can be found on the NELF website (*nelf.org*). There are currently less than 500 certified elder law attorneys in the entire country.

Q: Some taxpayers who made large lifetime gifts during the latter part of 2012 in anticipation of the "fiscal cliff" are now having misgivings, and some professionals are offering up various ways to "reboot" trusts. How do you feel about utilizing approaches such as "decanting" trusts?

A: It's nice to get another bite at the apple! Decanting assets from a trust offers a nice solution where it is permitted by the trust and/or applicable state statutes. New York has a good decanting statute, and several states have followed New York's example. But it can't just be assumed that it is always an applicable option.

Q: Is the impact on trust income enough to warrant remedies to address existing trusts, such as decanting assets or swapping out assets?

A: It can be, depending on the size of the trust. With a top rate of 39.6% applicable to trust income exceeding $11,950 for 2013 (plus the 3.8% Medicare tax), many existing trusts may need to be adjusted.

Q: Trusts already had a steep progressive rate schedule, but did we just reach a tipping point in how trusts are utilized in estate planning as a result of ATRA? Going forward, will you feature trusts in estate plans the way you have in the recent past, or will you apply a revised set of thresholds before advising clients to use trusts?

A: It depends on the context, but, in general, ILITs [irrevocable life insurance trusts] have become questionable unless the estate is large enough—closer to $5 or $10 million. There is a shift in emphasis with less use of credit shelter trusts due to portability. Although sophisticated estate planners know better, clients see bypass trusts as unnecessary because they can elect to rely on the portability of the first spouse's unused exemption. Clients just don't want to spend money on sophisticated planning without clear benefits.

Q: What about the use of credit shelter trusts in those states that still have their own transfer taxes, such as New York (with an estate tax that applies after an exemption of $1 million) or New Jersey (with an estate tax that commences after an exemption of $675,000)?

A: Use of credit shelter trusts to take advantage of smaller, state-level exemptions is still useful for spouses. For New York, after an exemption of $1 million, there is a potential tax of up to 16%. Preserving a spouse's state exemption has value, and many clients are looking at this option. These trusts also provide significant asset protection value.

Q: For wealthier estates with married couples, does the permanence of the portability provision mean the end of the QTIP trust and a shift to "I-love-you trusts?"

A: No, not if you are in a second marriage. For spouses who remarry, the QTIP still is relevant for protecting the disposition of assets and also protecting assets from creditors.

Q: A lot of existing wills contain QTIP trust structures. Should planners approach these trusts with the mindset that they may still have some merit, or should they assume that these are now to be presumptively less desirable?

A: The evaluation needs to be case by case, based on the issues of each situation. However, a given QTIP should not be presumed to be worthless or less desirable.

Q: How can existing trusts be adjusted to reduce the impact of higher taxes?

A: Flexibility can be incorporated into a grantor's current trusts by providing the trustee with the power to substitute property of equal value. Utilizing powers of appointment can also be useful.

Q: You've mentioned income-only trusts as a very favorable option.

A: Income-only trusts can be very useful. They are grantor trusts, and the asset is includable in the estate under Section 2036 and qualifies for a basis adjustment with a step up for heirs under Section 1014. In addition, the grantor retains an income stream to live on; the income is taxed at the grantor's income tax rates, which will be lower than applicable rates for the trust. The assets in the trust are protected from the creditors of the trust beneficiaries and, if a domestic asset protection trust (DAPT) is used, from the grantor's creditors as well.

Q: What are the most relevant questions or issues that you are now fielding as a result of ATRA?

A: After my Heckerling presentation, many of the professionals attending the session approached me with questions about their own parents. So, even though it was a high-quality audience with planning backgrounds, they all had families and wanted to confirm how to handle their own situations.

Q: With some quasi-stability in the transfer tax universe, should Congress keep its hands in its pockets for a while, or are there some remaining items that you'd like them to tweak?

A: Congress should leave everyone alone! Every time they touch something, they seem to make it worse. We need tax simplification, not tax complication.

Note: Many thanks to renowned attorney Richard Oshins for setting up the interview with Bernard Krooks.

Bernard A. Krooks, JD LLM CPA CELA AEP, is nationally recognized as a preeminent authority on elder law, special needs planning, and estate planning. He has testified before Congress; appeared on CNN, CBS, NBC, PBS, Sirius, etc.; and is regularly quoted in The New York Times, The Wall Street Journal, Forbes, *and numerous other print outlets. Mr. Krooks served as President of the National Academy of Elder Law Attorneys (NAELA), as well as the Special Needs Alliance. He continues to serve extensively on editorial boards and committees, and he authors many articles and book chapters that professionals rely on. At the 46th Annual Heckerling Institute on Estate Planning, Mr. Krooks presented a general session titled "*The Use of Irrevocable Income-Only Trusts in Elder Law Planning,"*at this year's 47th Annual Heckerling, he presented an elder law update. Bernard Krooks is a founding partner of the law firm Littman Krooks LLP, 655 Third Avenue, New York, New York 10017, (212) 490-2020.*

Income Only Trusts & Post ATRA Elder Planning

An Interview with Attorney Bernard A. Krooks

Q: How are you feeling about Elder Law in the wake of ATRA? Is Elder Law any different as a result of ATRA in reality, or is this just a matter of perception?

A: ATRA didn't really change elder law. The types of trusts drafted are affected, and the health tax and income tax planning have been affected. With the new law, planners need to make sure trusts are grantor trusts to avoid the top tax at $11,950. By comparison, the top tax rate affects a married couple for annual income exceeding $450,000. We've always done grantor trusts anyway, but now there is greater importance on it.

Q: Is there a standard capital gains approach for elder law planning?

A: With the new capital gains tax at 23.8% for many clients, that represents slightly more than a 50% increase in applicable rates. But, in the elder law context, many clients don't have taxable estates. Whenever that is the case, it often makes sense to have the capital assets included in the elderly client's estate so that the assets subsequently will pass to heirs with a stepped-up basis.

Q: Are certain jurisdictions especially favorable or detrimental for elder law purposes? For example, are some jurisdictions worth seeking out or avoiding based on their probate recovery posture for Medicaid or for other elder law policies?

A: Medicaid enforcement varies from state to state. Forum shopping is possible but tends to be rare. Forum shopping can be relevant when better care is available in one state versus another and people live close to the state line. People need to be near families. The tail doesn't wag the dog. People don't generally move to states for care the way they do for asset protection issues.

Q: What is the tipping point for having someone make their estate Medicaid-ready? Should this be based on a particular estate value, such as falling under the $400,000 estate level? Or should most of the emphasis for such decisions be placed on health, family, and other nonfinancial issues?

A: This depends on many factors…age, health, prognosis, cost of care. The national average is $90,000 in annual nursing home costs, but in states like New York, the cost can be more than $250,000 annually. So there is no general rule of thumb for making an estate prequalified for Medicaid. In general, though, qualifying for Medicaid should be a last resort.

Q: Is there a suitable time for gifting a home into a family member's name instead of a senior citizen?

A: Only if you have a working crystal ball. If you move a house at the wrong time, the family member gets a carryover basis that results in high capital gains when the home is sold.

Q: In your analysis and drafting of income-only trusts, when is the best time to set up such a trust? Who makes the best candidate for such a trust?

A: The best candidate is anyone with money to protect. About 70% of Americans will need some form of long-term care, and many of those will need a nursing home at some point. So almost any aging grantor should consider an income-only trust as a potential option.

Q: Is an income-only trust advisable for a taxpayer who resides and owns real estate in a jurisdiction that applies an aggressive probate recovery for Medicaid purposes?

A: Each state is required to have an estate recovery program under OBRA-1993 and has the option to go beyond the probate estate and seek assets passing by operation of law. Not every state goes that far. In addition, many of the states are not sophisticated in recovering assets out of state—they go for the low-hanging fruit and sometimes overlook out-of-state assets that are inconvenient to secure. It is critical to work with someone local who is familiar with the probate recovery policies.

Q: What if a taxpayer wants to use an income-only trust but also retains something comparable to "life rights?"

A: If a state only recovers against probate assets, then life estates are protected. If it has a non-probate collection effort, then it may attach only what the life interest is worth at the time of death.

Q: The 60-month look-back rule can present grave difficulties to families. Some seniors who might otherwise remain independent may feel compelled to divest themselves of assets prematurely. What can you advise these people or Congress about this issue?

A: One of the biggest misconceptions is that if you don't act there is nothing you can do. Yes, it is preferable to act earlier, but it is never too late to plan. It is possible to save 40% to 50% of what is left in many cases, even without advance planning. The outcome varies from state to state, based on applicable rules. In some estates, there have been exempt transfers that were overlooked. Promissory notes and annuities can also provide relief, depending on the state laws involved.