

## The Estate Planning Advisor

### Irrevocable Trusts For Asset Protection

By Richard J. Shapiro, J.D.

Perhaps the most frequent question we hear from people is “how can I protect my assets from the high cost of long-term care?” Long-term care insurance is probably the best overall choice. But many people do not consider purchasing long-term care insurance until later in life, when the insurance may be too expensive or is unavailable due to medical ineligibility.

Fortunately, there are other options. The use of a properly structured and funded irrevocable trust can help preserve a significant portion of person’s assets. Such a trust is most effective if created and funded at least five years before the creator of the trust (and his or her spouse, if any) requires institutional long-term care. This five-year period represents the Medicaid “look back” period during which any transfers to others (including irrevocable trusts) will cause a period of Medicaid ineligibility. If, however, one does not need to apply for nursing home Medicaid within 5 years after funding assets into the irrevocable trust, then under current law the transfers made to the trust do not create any period of Medicaid ineligibility.

An irrevocable trust is simply a contractual agreement between the person creating the trust (the “Trustmaker”) and the person who will administer the trust (the “Trustee”) for the benefit of one or more third parties (the “Beneficiaries”). A significant advantage of the irrevocable trust over outright gifts to children is that the parent retains rights to all of the income from the trust, with the income being taxed to the parent rather than the child, often at a lower income tax rate. For clients who have no intention of using their principal but need the income, this feature holds great appeal. Also, making gifts into a trust allows the client to make gifts “with strings attached.” The client can retain the power to replace the trustees (who are usually one or more children), and can even retain the power to change the beneficiaries of the trust (i.e., the parent can disinherit one child and give their share to a grandchild, another child, etc.). The trust assets are also protected if any child or other beneficiary should suffer a financial hardship such as a bankruptcy or divorce.

Another benefit of the irrevocable trust is the ability to avoid capital gains taxes upon the ultimate sale of the assets. Under current law, if the assets are held in the trust until the parent’s death, the assets in trust will receive a “step up” in cost basis. That is, the assets will be revalued for tax purposes using the value at the parent’s date of death. For example, if a share of stock with an original cost basis of \$10 is given outright to a child and then sold for \$100, the child will have a taxable gain of \$90. If the same stock is placed in the trust and held until death with a date of death value of \$100, the same sale will produce *no taxable gain*.

Transferring a primary residence to an asset protection irrevocable trust retains the “step up” in basis advantage, and further benefits the parent by allowing them to retain (1) a lifetime right to remain in the residence and (2) all the various property tax exemptions which they may already have (i.e., STAR, Veterans, etc.). Also, if the home is sold during the Trustmaker’s lifetime (with their consent), the Trustmaker retains the capital gains exemption available to homeowners (\$250,000 exemption for single people, \$500,000 for married couples).

For clients in at least fairly good health, an irrevocable trust can be a powerful planning tool when included as part of a comprehensive estate plan.

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