Estate planning with long-term care and irrevocable trusts

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*Licensed, not practicing.

In estate planning, one of the most important Internal Revenue Code provisions is IRC 2036. This section is relatively simple in its concept: If a person transfers property or assets to a third-party (including trusts), but retains a "string" of receiving financial benefits or a "string" of control over the assets, then for estate tax purposes the transfer is deemed to have never occurred, and the assets remain with the transferor's estate.

In essence, if you transfer property and retain financial interests or controls, it's exactly the same as if you never transferred the property at all, and thus the assets should be included in your estate.

The exact language of IRC 2036 is extremely broad. Subsection (a) states:

> "The value of the gross estate shall include the value of all property to … which the decedent has at any time made a transfer … by trust or otherwise, under which he has retained ….-
>
> (1) the possession or enjoyment of, or the right to the income from, the property, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."

A potential problem arises if a grantor establishes a trust, and the trust purchases a *MoneyGuard*® policy or a Lincoln life policy with the long-term care (LTC) rider. Since both are considered reimbursement LTC vehicles, in order for the trust to receive benefits, the trustee must provide receipts.

Receipts would show a direct benefit between the trust and the grantor assuming the insured is the grantor. While there is no precedence on point, most careful planners avoid creating trusts where the trust owns a reimbursement LTC vehicle on the grantor, since this clearly seems to be both a retained "beneficial enjoyment" and a "retention of a right to income." Either of these interpretations would trigger estate tax includability — even if LTC benefits were never exercised.

This information is for educational purposes only and nothing is meant to be mistaken as tax or legal advice.

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The trust options

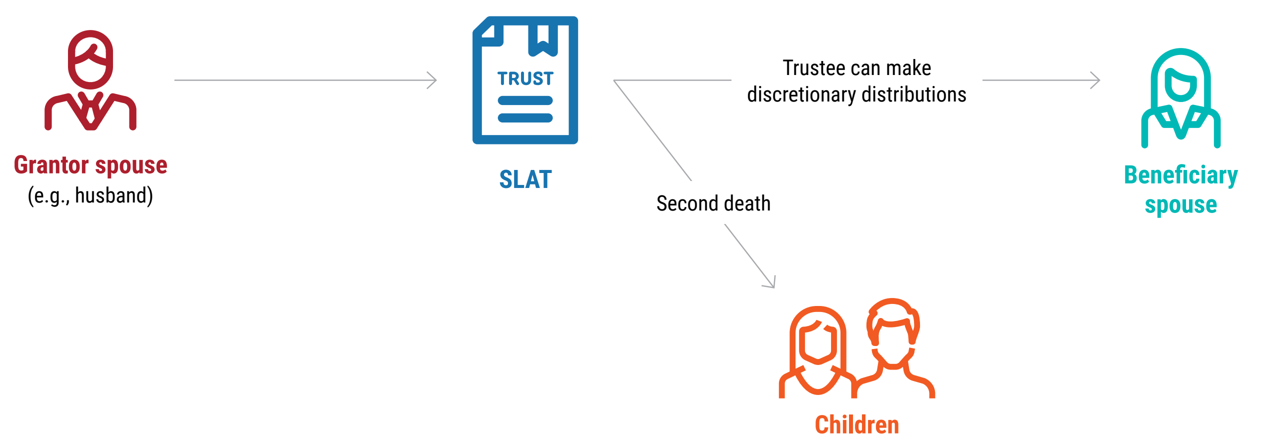
It's important to note that for IRC 2036 to apply, two "legs" to the transfer must occur. First, the trust grantor must be the person transferring the property. Second, the benefit in the trust must accrue for the benefit of the grantor. If only one of the two legs occurs, there is no IRC 2036 issue. It's this ability to separate the legs that allows for trust planning involving LTC reimbursement products. We have two potential options to address this situation, as follows.

Option #1: SLAT Trusts

A spousal lifetime access trust (SLAT) as a planning vehicle was established in Private Letter Ruling 9748029. According to the PLR, the SLAT has one spouse establishing the trust with its benefits going to the second spouse (and at second death to their children). The trust must be funded with separate assets of the grantor spouse. If joint assets or community property is used, then the beneficiary spouse will also be deemed to be a transferor, causing IRC 2036 to be triggered.

Here's how it works: Spouse A funds the trust. The trust purchases a *MoneyGuard*® policy or a Lincoln Life policy with a LTC rider on spouse B, who is a trust beneficiary. Since the LTC benefits do not accrue to the grantor, spouse A, there is no IRC 2036 includability. In many SLATs, a reciprocal trust will be established where spouse B is the grantor, and spouse A is the beneficiary and the insured for the LTC benefits. In the case where spouses establish reciprocal trusts, a few of the trust terms must be different in the respective trusts. If the trust terms in the two trusts are exactly the same, the IRS can collapse the separate trusts into one, and trigger IRC 2036. Since each taxpayer situation is different, your client should discuss their specific facts with their own legal and tax advisor.

How a SLAT works



Option #2 : PLAT Trusts

A parent lifetime access trust (PLAT) operates similarly to a SLAT, except a child of A is the grantor, and A is the trust beneficiary. For example, child is a successful 50-year-old and establishes a trust for parent A. Child funds the trust with cash. The trusts owns a *MoneyGuard*® or a Lincoln Life policy with the LTC rider on the life of A. If A becomes eligible for benefits, the trustee utilizes the *MoneyGuard* policy or the LTC rider to pay for the services provided to A.

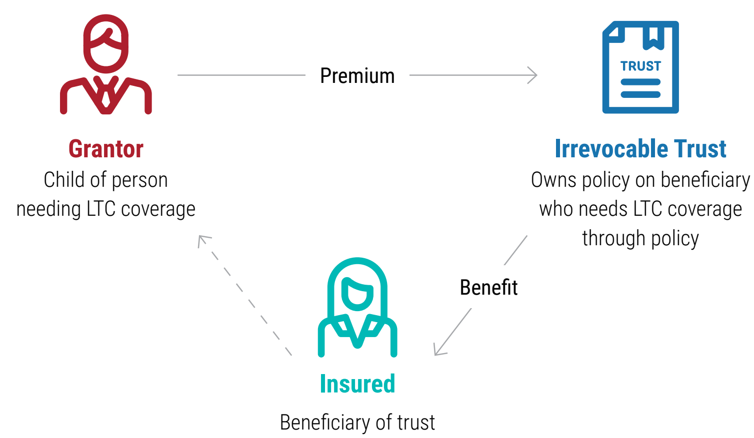
It's possible for beneficiary parent A to gift money to child, who in turn, uses the money to fund the trust for A's benefit. A could use the lifetime exemption and/or annual exclusions to avoid the gift tax. However, it's necessary to carefully structure the gift from A to child so that it's not deemed a "step transaction," or a transaction where child is operating as an agent of A.

In either case, the IRS may collapse the series of transactions and then apply IRC 2036. To reduce the risk of this happening, all steps must be taken to make the gift from A appear separate from the funding of the trust by child. This includes the gift being separated in time from the funding of the trust. There should be no agreement that child must use the gift to fund the trust — child must have unfettered control of the gift proceeds.

Finally, the gift and the trust funding must be in different amounts. Because of the care needed for a gift to child, and then child funding a trust for the benefit of A, consultation is needed with an independent tax attorney. One should not rely on this flier to justify such a transaction. Actual cases are different from the hypothetical discussion presented herein. Lincoln does not provide any guarantees that such a transaction will ultimately work. Taxpayers should discuss their own situations with their legal or tax advisors.

How a PLAT works

Insured can gift premium to grantors. Care is needed to avoid "step transaction" attack. Gift should be in an amount different from premium and should be made at a date not close to premium due date. Needs to be clearly a separate transaction from premium payment.



Speak with your Lincoln representative to learn about trust options for long-term care protection.

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