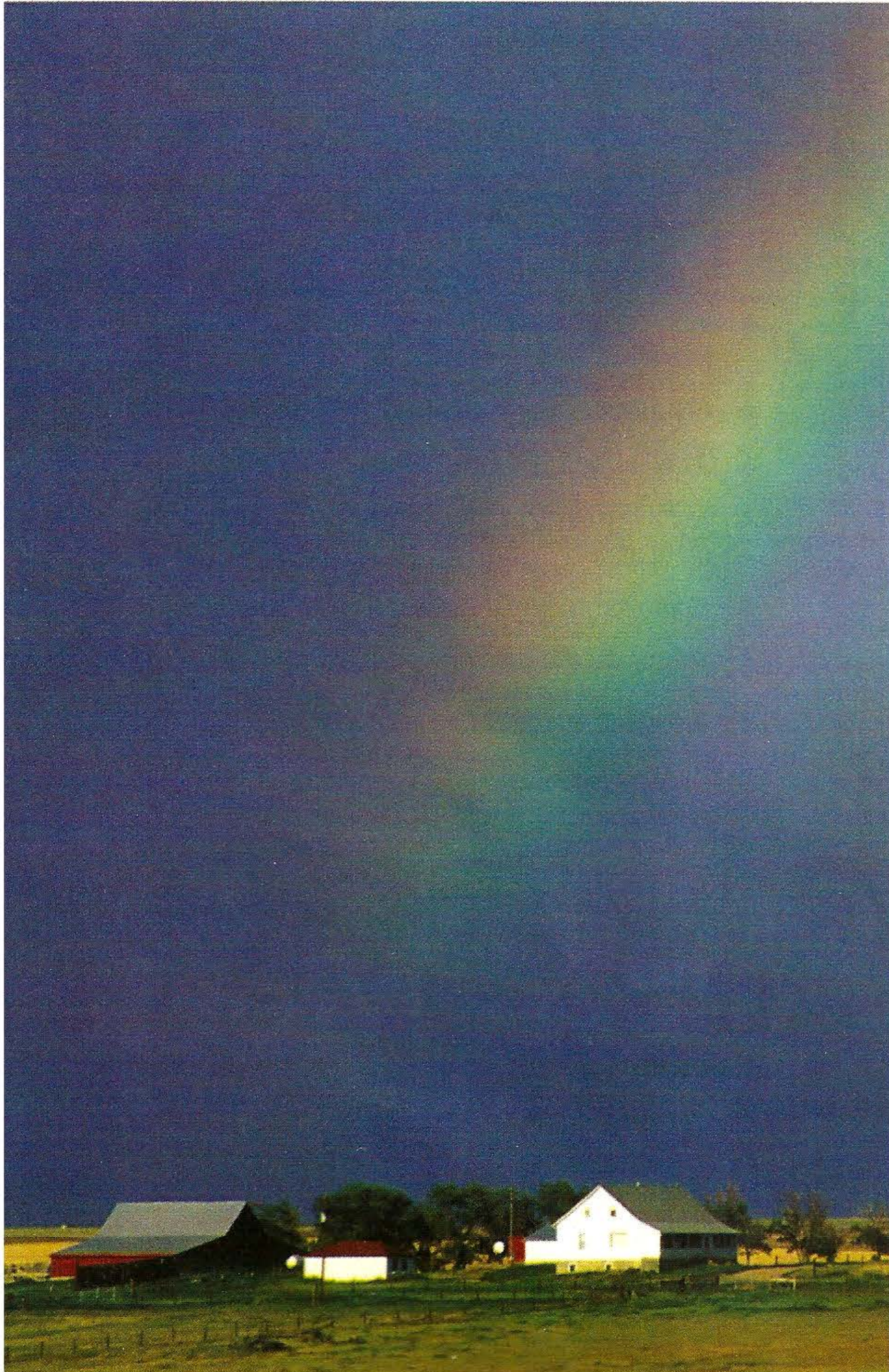
PROTECT YOUR RANCH

You'll need a lawyer, but a certain trust can help protect your assets.

BY C. DAN CAMPBELL



FARMERS AND RANCHERS often worry about what may happen if their health fails and they wind up in a nursing home. The worry is very real with nursing home costs running $4,000 to $5,000 per month, depending on the level of care. Sure, long-term care insurance is great if you have it or can afford it. But only a small percentage of folks have it.

There is, however, a way to protect the farm or ranch, and it can be done by what lawyers (who know and understand Medicaid and the IRS tax code) call an "irrevocable intentionally defective grantor trust." (We'll call it "the trust" in this article for simplicity's sake.)

The problem: The parents, John and Jane Doe in their 70s, own Blackacre Farm, which has been in the family for generations. When John's father died, John inherited it. Its 250 acres are now worth $200,000. (It was worth $20,000 when John inherited it.) John and Jane have $100,000 in savings. They have two kids, Sam and Sarah, who work in town but also help with the farming operation. John and Jane are worried about what would happen to their farm if one or both of them had major health problems, necessitating nursing home care.

The solution: The parents go to a lawyer who has extensive experience with Medicaid and the Internal Revenue Code for help. He recommends "the trust." This trust has certain provisions that are rather unique:

- The parents retain the right to the income from the trust for life.
- The children (or anyone other than John and Jane) are named trustees.
- The children are named as "remaindermen" of the trust — they get what's left in the trust when John and Jane die.
- John and Jane retain the right to "substitute" assets equal in value to what they put in the trust.

- John and Jane retain a "special power of appointment" — the right to change who will receive the trust principal when they are both deceased.
- John and Jane appoint a "trust protector" (John's brother or perhaps their accountant) who is a "watchdog" and has the power to remove the original trustees, if he feels they are not doing their job, and appoint someone else.

How it works: After the trust is created, John and Jane deed the farm to the trust. They may also choose to transfer some of their savings to the trust. After the transfer occurs, there is a five-year "waiting period." During this five-year period, if either or both need nursing home care, they will have to "private pay" out of their own resources. They will receive all income from the trust each year. If they do not have enough money to private pay (during the five-year period following the creation of the trust), the children could distribute assets to themselves and, in turn, pay the nursing home bill out of that money.

After five years, the trust "principal" (i.e., the farm) will no longer be "countable" for Medicaid purposes. They will still receive the income, but the income might be diminished by paying the kids for operating the farm. Also, if the assets contributed to the trust are stocks, bonds or certificates of deposit, for example, after five years, the trustee might decide to change the "mix" so that the assets are no longer producing much income and instead are invested in "growth type" assets — thereby reducing the amount of income going to the nursing home.

Why use the trust? Three reasons. First and foremost, we are able to protect the family farm or ranch (or investment portfolio) — after five years it's no longer countable. Second, the parents receive the income from the farm or ranch (or investment portfolio) for life and retain significant control via the power of appointment and power of substitution. Third, when the parents die, the assets in the trust get a "stepped-up basis" for income tax purposes. (Recall that when John inherited the farm it was worth only $100 per acre; when he dies, assume it's worth $1,000 per acre. If the farm is in the trust, it will be entitled to this "stepped-up basis" of $1,000 per acre, and if the kids sell the farm when the parents are both gone, they will not pay any income tax except on any amount it sells for in excess of $1,000 per acre.)

Why not make an outright gift to the kids and not use the trust? If the parents do that, there will still be a five-year "look back period" on the gift. But the parents will not have the right to the income from the property. And when they die, the kids will not get the stepped-up basis.

Who should I see for Medicaid planning involving an Intentionally Defective Grantor Trust? You should confer with an attorney who is very knowledgeable about the Medicaid law and the Internal Revenue Code.

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