Handling the House and Family Caregiving Arrangements

"The epitome of sophistication is utter simplicity."
Maya Angelou, <u>Letter to My Daughter</u>, 2008

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Introduction

More persons who are elderly or adults with a disability are choosing to live under one roof with family members. The residence is often a main asset for clients and directly related to their emotional security. Public benefits under Medicaid, SSI and the Veterans Administration prioritize and even reward remaining at home with family care arrangements.

As such, attorneys increasingly face requests to handle the house and family caregiving as part of the estate planning process. The desire to avoid probate, to protect the home against loss and to alleviate overall costs to the family make "simple" deed transactions quite common. Life estate deeds, deeds to a trust or joint ownership arrangements may seem a simple solution. ***These "simple"requests, however, often have significant legal, tax and Medicaid effects which are <u>not</u> contemplated.***

In fact, family caregiving relationships often exact a significant emotional, physical and financial toll on the caregiver and other relationships. Accountability, access, safety and respite are difficult to clarify in the home setting. Concerns of undue influence, inappropriate control, earned income and gifting penalties have caused increased scrutiny with the probate court, Medicaid and the IRS.

Estate planning attorneys serve their best role in anticipating these "red flags" before they become problematic. At the same time, we are able to honor family preferences and strengthen the financial security of the client. This seminar is broken into ***four major steps*** to tailor the most effective legal framework for handling the house and family caregivers.

Step #1: Clarify client identity, capacity, free will and representation.

- ***Learn and apply the lessons*** from the recurring court conflicts and ethical mistakes involving incapacity, undue influence, conflicts of interest and attorney/client privilege.
- ***Differentiate healthy relationships and routes from abusive ones.***
- ***"Slow down to speed up" the estate planning process.***
- ***Document your relationship with client and the caregiver relationship.***

Step #2: Compare the effects of various title and payment arrangements with family members on:

- ***Control issues*** involving management, transfers, sales and survivorship rights
- ***Creditor issues*** involving the new co-owner's liabilities, premises liability and claims through government benefits
- ***Gifting complications*** with deed delivery and contribution issues
- ***Exemptions to gifting penalties*** under Medicaid for house title transfers
- ***Exemptions to gifting penalties*** under Medicaid for caregiving contracts
- ***More gifting issues with*** federal gift tax reporting and tax apportionment
- ***Property tax issues*** with uncapping and loss of the homestead exemption
- ***Real estate transfer taxes*** upon purchases
- ***Capital gains tax*** concerns upon sale of the residence
- ***Estate recovery*** concerns with Medicaid, and
- ***Employment and income tax*** issues with caregivers.

Step#3: Apply the proper legal tools to handle the house in light of the caregiving situation:

Carefully reflect written understandings about the family caregiving and title arrangements in light of increased regulation and rewards.

- Define the relationship, costs and payments of a family caregiver.
- Pay close attention to benefits from title arrangements in instances where exemptions to Medicaid divestment and estate recovery overlap.
- Consider removing the name of a chronically ill spouse in most instances.
- Consider a "life estate deed" or a "Lady Bird" deed for the house, especially when a caregiver child is involved.
- Consider a caregiving contract when a caregiver child moves into the home of the elder person or sibling with a disability.
- Consider a rental contract when a parent moves into the caregiver child's home.
- Consider a co-ownership agreement when the elderly parent or person with disability invests significant dollars in the caregiver's home.
- Consider special needs trust planning with an LLC for private group home arrangements for an adult child with a disability.

Step #1: Clarify client identity, capacity, free will and representation.

Attorneys may fail to understand or ignore the complications involving weak or vulnerable clients, unwittingly facilitating abuse by providing legal tools in the pressures of the situation.

Probate case law is replete with contentions about transfers to caregivers, especially involving the house as the main asset.

- In re Zaborski, Docket No 209055(Jun 30, 2000) Michigan Court of Appeals Opinions – Unpublished (determination of undue influence by caregiver son affirmed)
- In re Haynes, Docket No 235232 (Nov 18, 2003) Michigan Court of Appeals Opinions – Unpublished (determination of undue influence by caregiver ex-spouse and her son affirmed)
- In re White, Docket Nos 279866, 279867, 281420 (Nov 18, 2008) Michigan Court of Appeals Opinions – Unpublished (cousin and friend caregiver not found to have acted under undue influence).

Undue influence is difficult to identify and even more difficult to prove. A presumption of undue influence occurs with evidence which would establish:

1. the existence of a ***confidential or fiduciary relationship*** between the grantor and a fiduciary,
2. the fiduciary or an interest which he or she represents ***benefits*** from a transaction, and
3. the fiduciary had an ***opportunity to influence*** the grantor's decision in the transaction.

In re Karmey Estate, 468 Mich 68, 73; 658 NW2d 796 (2003) [emphasis added]; *Kar v Hogan*, 399 Mich 529, 537; 251 NW2d 77 (1976); *McPeak v McPeak (On Remand),* 233 Mich App 483, 496; 593 NW2d 180 (1999).

Understand and screen for these subtle concerns, which rarely "announce" themselves.

Consider the process of abuse to differentiate it from a healthy situation. The experienced elder law and disability attorney seeks to differentiate healthy and constructive relationships from inappropriate and potentially abusive relationships.

First, understand <u>the common route of an "abusive" caregiver</u>:

- The ***hidden motive*** of the caregiver meets
  the ***opportunity*** of the frail character of the family member.
- The ***authority*** as helper or fiduciary crosses the line through
  the ***power of suggestion*** which panders to fear in an ***isolated situation.***
- An otherwise ***inappropriate benefit*** results, which the abuser relies upon and latches onto (eg., taking title to the home).
- The caregiver then ***excludes other relationships***, through denying access by others or accountability to others.

Second, understand <u>the pattern and perspective of the victimized person</u>:

- ***Diminished capacity*** to understand care options and healthy solutions, becomes entangled with ***physical frailty***.

- ***Fear of loss*** of independence and financial security and even ***paranoia***, then becomes coupled with
- A ***solitary reliance*** on the caregiver.
- A ***sense of indebtedness*** or ***desperation*** then results in otherwise ***inappropriate promises***.
- The victimized person then ***identifies, justifies and even defends*** the abuser's unnatural benefit; and
- The victim ***pushes away*** otherwise healthy forms of safety and accountability depending on the caregiver alone.

An excellent resource for this dynamic is the <u>Journal of Elder Abuse and Neglect</u>, a quarterly journal routinely analyzing these dynamics, published by Hayworth Press.

"Slow down to speed up" the estate planning process for the best results for the vulnerable client:

- **Identify clearly "who" is the client.** Are you representing the client with his or her estate plan? Or, are you representing the client's fiduciary in complying with their fiduciary responsibilities as Guardian, Trustee, etc.?

- **Meet the client at your office if possible.** Meet in the professional setting of your office if possible. Meeting at the home or care setting weakens the respect for your ethical duties with confidentiality and assessment, even just from interruptions and lingering.

- **Meet alone with the client, at least initially.** Excuse the caregiver from the office and address that expectation before sitting down. Refusal of the caregiver to support the integrity of this request, especially for the initial interview, is a definite "red flag".

- **Consider transportation and accessibility.** Health concerns may make the person dependent on caregivers for transportation. Explore alternatives with the client. If the client must be transported by the caregiver, ensure the expectation is that the initial meeting and execution meetings are alone. Work on ways your office is more wheelchair accessible.

- **Screen for "red flags".** Analyze the "close and confidential" relationship between the client and the family or friend:

    - Was the family caregiver otherwise unemployed?
    - When did the caregiver move in?
    - Is the caregiver isolating the person with disability?
    - Do the other siblings support the caregiving relationship?
    - How is care status being communicated to outsiders?

- **Involve a multi-disciplinary approach.** Undue influence concerns shifts the burden of persuasion against a caregiver receiving a benefit. Encourage evidence of healthy relationship through verification and monitoring by other professionals. An independent evaluation by a geriatric care manager will screen for unhealthy signs. Obtain permission to work with the client's other longstanding professionals to monitor the situation, such as the primary care physician, clergy and accountant.

- **Clarify your client relationship in writing** regarding the nature and scope of representation. Also clarify the attorney/client privilege and communications with the fiduciaries assisting with care and finances**.** This often provides the crucial protection against conflicts of interest.

Step #2: Compare the effects of various title and payment arrangements.

Having addressed such ethical concerns, the attorney's technical hat goes on. The attorney should convey the serious effects of title changes and caregiver payments in ***layperson's language***.

1. *Control issues involving management, transfers, sales and survivorship rights.*

Co-ownership arrangements bring the potential for disagreement with the new co-owner. These are some concerns involving loss of control with co-ownership:

- Has the client considered the possibility of **loss of her unilateral powers** to sell, occupy, mortgage or split a property?
- Or, on the other hand, is the client concerned that the new co-owner can **transfer the interest without permission** to new owners?
- Has the client now become subject to the new co-owner's **veto in major decisions** about the property?
- Will the **survivorship rights actually work** as the client expects?

Consider how the different types of title relationships affect the original owner's control of the residence:

(And dust off your Michigan bar exam review with these nuances/ updates)

- A **tenant-in-common** has the unilateral right to transfer his or her respective interest – and may result in partners never planned. In addition, a tenant-in-common may be stuck with her new co-owner, because she cannot unilaterally force the sale of the entire property on her own. Absent consent of the co-owner or a prior written agreement with the co-owner, if she wants to sell the entire property (or as a practical matter, even her own interest), she will be forced to pursue a partition sale in circuit or probate court.

Consider also this common mistake with "quitclaim deeds" intending to avoid probate: tenancy-in-common is presumed when names are merely listed and the words "joint tenants" or "joint tenants by right of survivorship" are absent. MCL §§554.44, 554.45; Michigan Land Title Standard 6.1.

Because of this presumption, without the proper language, a deed intended to avoid probate may actually *force* a probate on the death of a co-tenant, because there is no right of survivorship among tenants-in-common.

- A **joint tenant** (without the words "with full rights of survivorship") has a survivorship right among the other joint tenants. The trap with this language is the unique character of the new co-owner's rights involving transfers. A joint tenant can unilaterally transfer his or her respective interest to a new owner, which may result in partners never planned. In such instance, however, the remaining owners are then converted to a tenancy-in-common in respect to the new owner, with no survivorship right in respect to the new owner. Smith v. Smith, 290 Mich 143, 287 NW 411 (1939); Michigan Land Title Standard 6.2.

- A **joint tenant with a right of survivorship** is the most common form of "quitclaim deed" transfer. As intended, there is a survivorship right among the co-owners. But consider this unique aspect: a "joint tenant with rights of survivorship" may only convey her life estate interest, with no effect on the survivorship rights of the other joint tenant. Albro v. Allen, 434 Mich 271, 454 NW2d 85 (1990); Snover v. Snover, 199 Mich 6, 130 NW2d 900 (1964); Michigan Land Title Standard 6.4.

  Like tenancy-in-common, all joint tenancy arrangements lack the unilateral right to force the sale of the entire property absent forced partition sale or prior written agreement. Without legally clarifying rights among joint tenants, your client may be stuck with the property and unable to sell it without serious court costs.

- A **life tenant** must also get the remainderperson's permission to sell her interest or get out, unless the unilateral right to partition or sell a property is maintained by a life tenant. MCL §§556.122, 123, 129; Michigan Land Title Standard 9.3. A **"Lady Bird deed**" involves a life tenant retaining a general power of appointment, which includes the right to change the remainderperson back to herself. This general power of appointment retains control by allowing the client the sole power to sell the entire property. Id.

  See discussion below and example of "Lady Bird" deed under **Exhibit C**.

- A common solution for single clients to avoid probate upon death, but also the pitfalls of joint ownership is to title the residence in the client's **grantor trust** (as a revocable living trust). Such deeds do not involve a loss of control by the client, unless the client established an irrevocable trust with other current beneficiaries and failed to retain the power to sell or to substitute the property. Michigan Land Title Standard 8.4. See IRC §§671-678 for the grantor trust rules applied for income tax purposes but related to issues of "control".

- Most married couples simply hold title to their residence as "husband and wife." Such ownership as **"tenants by the entirety"** does not allow one spouse to sell or transfer his or her interest to anyone but the other spouse without the other spouse's signature. Michigan Land Title Standards 6.8 and 6.9. Naylor v. Minock, 96 Mich 182, 55 NW 664 (1893). If the other spouse is incapacitated, the healthy spouse may not sell, transfer or remove the name of the incapacitated spouse, absent specific authority in a durable power of attorney or a protective order by the probate court granting permission for the title change.

- Consider also that the **"dower"** right of a wife continues as a statutory law in Michigan versus the **"curtesy"** right of a husband was abolished long ago. MCLA 558.1, *et. seq.*

  A **married man** may not transfer the property without his wife's signature. She has an automatic 1/3 interest through her dower rights in any of his real estate interests in her husband's name alone.

  A **married woman**, however, can unilaterally sell or transfer the property. Her husband does not have curtesy rights.

  Practice tip: these rights are especially significant when a married couple has children from prior relationships and one spouse needs nursing home Medicaid.

  In 2008 the Michigan Supreme Court vacated its decision to consider the constitutionality of "dower", leaving interpretation of the statute to the Eastern District Bankruptcy Court. *In re Estate of Miltenberger*, 482 Mich. 901, 753 N.W.2d 219 (2008).

- Beware of the effect of **"community property" rules** on both out of state residences <u>and</u> Michigan real estate when the couple had lived in a community property jurisdiction.

  Michigan is a "separate property" state. Unlike community property states, we do not have a presumption of one-half ownership for property acquired during marriage which is titled in the name of just one spouse.
  However, beware that real estate acquired during marriage which is either located in a community property jurisdiction or during residency in a community property jurisdiction will generally retain the special rules and

presumptions of that community property jurisdiction. **Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, Wisconsin and Puerto Rico** are all community property jurisdictions. **Alaska** is an opt-in community property state. No two "community property" states have the same rules or presumptions. Thus, it is important to consult with a competent attorney in that jurisdiction as to the effect on a residence acquired in a community property jurisdiction <u>or</u> on the Michigan residence itself when it was acquired during marriage and residency in a community property jurisdicition.

Special note: just because the couple now lives in Michigan does not mean the character of their residence as "community property" changes. For example, a married couple moves back from California to their Michigan residence to be near their caregiver children. If the Michigan residence was acquired during marriage and domicile in California, the Michigan property continues to be community property, even though the couple became later domiciled in Michigan.

- Titling the residence within a **limited liability company ("LLC")** is helpful especially for liability concerns when the client leases part of the residence to a non-family member. As a control matter, this title change has little effect when the client titles the property in her own **single member LLC,** retaining for herself the rights as sole member and manager. The client does not lose the ability to sell or transfer the property unilaterally, unless she adds partners to the LLC.

- It is when the house title changes to a **multi-member LLC** or to a trust with multiple beneficiaries that complications arise about control and management. This occurs frequently with the family farm or lake property residence. It is up to the operating agreement between the members of the LLC or the internal terms of the trust to regulate management, transfers of interests and sales of the residence.

Membership interests of an LLC are freely transferable absent written restrictions – thus involving potential unwanted co-owners (as in-laws). On the other hand, all Members must agree on the sale of the asset absent specific agreement – involving potential stalemates. As such, clear terms about management, transfers of interests and sale of the property need to exist in the form of an operating agreement, buy/sell agreement or trust agreement.

Practice tip: The operating agreement of an LLC can define dispositions upon death the same as other forms of joint tenancy and tenancy by the entireties. <u>See</u> MCL 450.4504 permitting the same rights of survivorship among members of an LLC in an operating agreement as personal property, even tenancy by the entireties between a husband and wife.

2. ***Creditor protection issues involving co-owner's problems, premises liability and government creditors.***

Now more than ever, consider these creditor protection issues for a client who is elderly or has a disability when analyzing the best title format for the residence:

- Does the client want her home affected by the new **co-owner's divorce, personal creditors or personal liabilities**?
- Are there concerns about a **general liability** occurring on the premises from other residents or invitees, causing personal liability to any of the co-owners?
- Will the house be protected against **claims by governmental creditors**, as claims by SSI and Medicaid?

Consider the effects these various title arrangements have on creditor protection:

- **All "tenancy-in-common" and "joint tenancy" arrangements subject the property to the co-owner's creditors, divorce or liabilities**.

  These arrangements are poor when a personal liability is contemplated by any of the co-owners. They also offer no protections to owners for liabilities occurring on the property itself.

- **Husband and wife ownership of "tenancy by the entireties" holds the strongest creditor protection against judgment creditors of one spouse.**

  This creditor protection extends even against most tax and governmental liens. This creditor protection is not limited to the primary residence. Estate planning attorneys are generally reluctant to broach this time-honored format of creditor protection in favor of a living trust or ownership arrangement in the name of only one spouse, unless there is good reason.

  Good reasons for not keeping the creditor protections of tenancy by the entireties occur when:

  1) One spouse is incapacitated or needs nursing care, especially if the spouse is likely to need Medicaid; or
  2) There are children from a prior relationship and outright inheritance of the surviving spouse may not assure the client's wishes.
  3) There is sufficient general liability insurance (as an "umbrella" policy) and titling the house in the trust of one spouse will better balance the estates between the spouses for estate tax purposes.

  Tenancy by the entireties does not protect against liabilities occurring on the premises itself, nor against creditors when the spouses are jointly liable.

- **When title to the home is in the name of one spouse, consider the effect of special rules involving the elective rights of a spouse on creditor protection**.

The elective right of a spouse in Michigan allows the surviving spouse to force rejection of an otherwise valid last will and testament in favor of his or her intestate, homestead and personal property rights. Creditors of the surviving spouse can actually force this spousal election in probate court. Absent valid waiver of this elective right by the Medicaid recipient spouse, other states have successfully forced this spousal election to assert its lien under estate recovery against real estate owned solely by the deceased community spouse.

> ***Planning tip:*** Michigan is <u>not</u> an "augmented estate" jurisdiction. As such, there are no elective rights of a spouse in Michigan against a trust, <u>only</u> against a will. Because of this exception, consider moving the house title to the trust of the healthy spouse and restricting any inheritance of the Medicaid spouse in the house to a testamentary trust for the benefit of the Medicaid spouse. A waiver of spousal rights by the Medicaid spouse should be completed if possible to ensure the state does not assert these spousal rights against the testamentary trust for estate recovery purposes.

- **Life estate deeds do involve creditor protection concerns, unless the life tenant retains the power to remove the remainderperson.**

When an original owner of a property retains a life estate, but adds a person's name to title as a remainderperson, there are the same creditor concerns as other co-ownership arrangements.

A remainderperson's judgment creditors can lien the remainderperson's interest to the extent that interest is vested. Those judgment creditors of the remainderperson can ultimately foreclose on the property at the death of the life tenant. The creditors of the remainderperson can also act against the property during the life of the life tenant if the life tenant does not maintain the taxes, maintenance, repairs or any mortgage on the property.

However, with a Lady Bird deed, where the original owner retains a life estate <u>and</u> the power to remove the remainderperson, then the remainderperson interest is not vested until death. As such, the creditors of a remainderperson cannot exercise any rights against the property until the death of the life tenant. If a creditor issue arises for the remainderperson during the life of the life tenant, the solution generally is to remove or change the remainderperson.

The original owner's retention of a life estate alone does not protect the property from judgment creditors of the original owner. A judgment creditor of the life tenant can force possession of property and either sell the life tenant's interest or rent the property to satisfy a debt.

See Alexander Bove and Robert Ryan, "Is There Still Meaning to Life (Estates) After the DRA," Vol. XVIII, 8, *The ElderLaw Report*, March 2007; see also Patrick J. Bond, "Lady Bird Deeds," Michigan Probate and Estate Planning Journal, Summer 2006.

A life estate deed does currently help protect the property against Medicaid estate recovery efforts in Michigan insofar as estate recovery is limited to "probate-only" assets. Because there is no probate of the property upon the death of the life tenant, the remainderperson receives full title interest without the lien of estate recovery. Other states with "enhanced" estate recovery are able to lien the house because estate recovery efforts are not limited to probate-only claims.

- **A "limited liability company" will shelter the member's personal assets from liabilities occurring on the premises.**

Such protection exists when the property is titled in the LLC and the LLC is properly administered. This protection may determine title arrangements when there are non-family members residing the house or special care is occurring in the house for non-owners, as a "Semi-Independent Living Program" ("SIP" or "SILP") home for persons with disability, discussed below.

However, individual ownership or "membership" interests of an LLC are still subject to claims of creditors or divorces of the individual members. As such, a Buy/Sell Agreement among the members often addresses a mandatory buyout in the event of such involuntary creditor or divorce.

- **A "special needs trust" protects the house from claims against the person with disability, even against exception creditors like the government under the SSI and Medicaid programs.**

While a person participating with SSI and Medicaid may own a house without affecting these public benefits, if the house is sold, there continued eligibility would be jeopardized. The house sale proceeds are considered a countable asset under Medicaid and a non-exempt resource under SSI unless segregated from other assets and re-applied into a new residence within **one year under Medicaid** (PEM 401) and within **three months under SSI** [USC §416.1212(d)].

Because the various means-tested government programs under SSI, Medicaid and HUD maintain asset and resource limits (as $2,000 under SSI and Medicaid), such proceeds can jeopardize participation in public programs.

When a special needs trust owns the residence and the residence needs to be sold, the special needs trust will protect the proceeds from affecting means-tested public benefits of the person with the disability.

There is, however, a difference in creditor protection depending on whether the assets of the special needs trust came from a third party (as a parent) or from a first party (the beneficiary himself or herself).

A special needs trust funded with assets from a third party (**"Third Party Special Needs Trust"**) will protect the residence from all creditor claims of the beneficiary insofar as all assets originated from third parties, the distribution standard is completely discretionary and there is a strong spendthrift or creditor protection clause. See Miller v. Dept. of Mental Health, 432 Mich 426; 442 NW2d 617 (1989).

- **A *first party special needs trust* is helpful when the house itself is owned or bought with assets of the beneficiary with the disability, instead of the parent or third party.**

Under Michigan law, the first party special needs trust will not, however, protect the beneficiary against other creditors existing at the time of the creation of the trust with the beneficiary's own asset. At the time of the beneficiary's death, the Medicaid payback lien is primary to all expenses even to the beneficiary's funeral expenses, but allowing for necessary administrative expenses.

- **The most thorough form of protection against creditors and loss of government benefits involving a residence of a person with a disability exists by a combination of a limited liability company ("LLC") and special needs trust.**

See below addressing recipe of use of LLC with special needs trust to accommodate other persons with disability in the home to share costs.

3. ***Gifting concerns with Delivery of Deeds and Contribution Issues.***

- **Unlike financial accounts, title changes to real estate involve immediate gift implications.**

Quite often clients mistakenly believe that adding a name to real estate title is no different than adding a name to a bank or brokerage account. A crucial difference, however, lies in presumptions involving a "completed" gift and ownership. Under both Medicaid regulations, SSI regulations and federal gift tax law, merely adding a name to a bank account for custodial and even survivorship purposes is not a completed gift until actual unilateral withdraw by the new joint owner. As to Medicaid, see PEM 405; as to SSI, see www.socialsecurity.gov, "Understanding Supplemental Security Income SSI Spotlight on Financial Institution Accounts, 2009 Edition.

In addition, Medicaid, Social Security and the IRS will only recognize claims of ownership by the new joint account person against the original owner insofar as contribution can be proved.

Opposite presumptions exist for real estate, where Medicaid, SSI and the IRS defer to state real estate title standards.

See, for example: Medicaid PEM 405 discussing the addition of a sister's name to real estate by brother, which presumes a completed gift of a one-half interest. It also presumes a gift of the entire real estate interest upon sister's refusal to sell.

Absent clear and convincing evidence, a new joint title holder is presumed to be a proportionate owner in the absence of clear direction from the grantor. Hill v. Reiner, 167 Mich 400, 132 NW 1031 (1911). The addition of the name under state law is considered as a completed gift for that proportionate interest when the deed under state law is considered "delivered".

- **Failure to record the deed is not sufficient evidence alone to rebut the presumption of a gift.**

Attorneys often assert that a deed is not considered "delivered" until it is recorded, not the date of execution. In fact, the attorney may offer to hold the unrecorded deed until the grantor's death. When a deed is not recorded, legal issues exist as to whether the conveyance fails because of lack of delivery.

State case law is replete with controversy over this subject of delivery. See article by Doug Chalgian, "Michigan Law and the Practice of Recording Deeds after Death," 4 *Elder Law Advocate* Issue 2 (June 2002), summarizing Hynes v. Halstead, 282 Mich 627 (1937) (gift failed for recording of escrowed deed after death); compare to Wandel v. Wandel, 336 Mich 126 (1953) (requiring present intent, irrevocable and unequivocal escrow arrangement).

Absent an unequivocal and irrevocable **escrow arrangements** evidencing present intent, the attorney should be careful with such unrecorded deed arrangements, especially for effect on Medicaid, SSI, gift taxes and property taxes.

Example: Same example under Medicaid PEM 405 detailed above, which discusses brother adding sister's name to deed. Brother's gift of one-half interest to sister is presumed upon the date of execution of the deed – not the recording date.

Practice note: Even if a deed remains unrecorded, the assessor's office pursuant to state law needs to be notified with an L-4260, "Property Transfer Affidavit" or there is a $5/day fine with maximum penalty of $200.

Because of this presumption of a completed gift and proportionate interests, the consequences of adding a name to real estate title as a tenant-in-common, joint tenant or even a remainderman can be dramatic under Medicaid and federal gift taxes. At the same time, because of special exceptions to divestment under Medicaid, the title change may be appropriate.

- **Co-ownership issues also bring complications of tracing contribution for Medicaid and IRS purposes.**

Many times a transfer is not done as a pure gift, but rather as a reduced price in light of other contribution issues. This is frequently a problem in which Mom or Dad purchased a house for son, who could not get financing through a bank. The parent's name may be on title, but son may have always paid for capital maintenance items (as property taxes and insurance). Tracing respective contributions for gift and estate tax purposes or Medicaid reporting can be a complex subject. The proof of such contribution, however, can make a significant difference on proving actual ownership.

4. *Exemptions to gifting penalties under Medicaid for title transfers*.

Since the 2006 Deficit Reduction Act, title transfers for less than fair market value must be reported at the time of Medicaid application within five years of Medicaid eligibility. Divestment penalties will force a return of title back to the Medicaid applicant or payment of fair market value except in limited circumstances, discussed below.

> ***Example involving Medicaid divestment:*** Mom adds son's name to her home worth \$100,000 as joint tenant with rights of survivorship. Mom needs Medicaid for nursing care. If the transaction occurred within five years of her needing to apply for Medicaid, then she will have to disclose the transaction. Because son is considered to be a proportionate owner of ½ of the property, Mom is considered to have gifted son \$50,000. To allow Mom eligibility for Medicaid and undo divestment penalties, Mom's name must be restored as sole owner or son must Mom pay the fair market value for the interest (\$50,000). However, if son falls within one of the exceptions listed below – has a disability or has been a caregiver child residing in the house providing the equivalent of nursing care for two years, <u>no</u> divestment penalty would occur.

There are however limited exceptions to transferring the house under Item 405 of the Medicaid Program Eligibility Manual. **Consider these exceptions to divestment which overlap as exceptions to estate recovery to protect the house:**

- **Remove the name of the nursing home spouse** with the community spouse retaining ownership alone.

- Pursue **co-ownership arrangements with a caregiver child** either involving the parent's home or the child's home when they are able to live together. Divestment rules do not penalize the transfer of the home to a child who resides in the home and provides nursing care for a period of **two** years as verified by a physician's letter. The same exception exists under federal estate recovery regulations.

- 2006 Deficit Reduction Act ("DRA") rules require that an individual who **purchases a life estate** in another person's home must actually **reside there at**

least one year after the date of purchase or such purchase will be treated as a penalized gift.

- **Example:** Mom moves into child's home and invests in the child's home retaining a life estate. Unless mom actually resides there at least one year, the transfer will incur divestment penalty under Medicaid, forcing a return of the investment.

- **Transfer the house to a disabled or blind child** or in the form of an OBRA'93 Medicaid Payback Trust if the child herself participates in SSI-type Medicaid.

- **Transfer the house to an adult child under age 21 or a sibling** with an equity interest in the home who has lived in the home for at least one year.

Consider also the "Lady Bird" deed as an exception to divestment, gift tax and the current estate recovery program. A "Lady Bird" deed does not result in Medicaid divestment penalties and federal gift tax consequences precisely because it is <u>not</u> considered a "completed" gift. Because the original owner retains the power to remove the remainderperson, and place all ownership interest back into her name or her estate, the gift is not considered divestment for Medicaid purposes. In addition, because of this retained right during lifetime, the full value of the house remains in the life tenant's estate for estate and gift tax purposes under IRC Sec. 2036, and thus is exempt from gift taxes during lifetime. Per the analysis below, a Lady Bird deed is an exception to the current "probate-only" estate recovery program.

5. Exemptions to gifting penalties under Medicaid for caregiving contracts.

When handling the house and caregiver, the attorney must also understand and treat the divestment complications involving any ***payments*** to family caregivers. This area has evolved significantly in recent years. Here's a history with required steps to comply with current Medicaid regulations.

1996 Medicaid regulations required written obligations and contemporaneous payment. Since 1996 Michigan Medicaid regulations have presumed divestment penalty for payments to a family caregiver unless there is a <u>written</u> <u>obligation</u> (i.e., caregiving contract) and payment is made at the time services were rendered. PEM 405.

- This regulation removed "bootstrapping" large lump sum payments to a child caregiver as exempt from divestment without proof of a written caregiving contract and contemporaneous payment for the services.
- As discussed above, the same regulations in 1996 allowed gifting the house to a caregiver child who resided in the house and provided the equivalent of nursing care for a period of two years. A doctor's letter was necessary to verify such care.

Understand caregiving contracts increased in popularity when the 2006 Deficit Reduction Act cracked down on divestment. Caregiving contracts generally lacked popularity because of the income tax issues triggered by the payment for services and the potential employment relationship. When the Deficit Reduction Act generally barred most gifting strategies, the use of caregiving contracts became more prevalent in the community.

- Caregiving contracts were expanded beyond the traditional home custody of the family caregiver to non-custodial contracts paying family to coordinate the nursing home care, assisted living care or adult foster home care. They were also expanded to "caretaker" contracts, in which a family member is paid to monitor and caretake the home. Contracts paying a lump sum up front for prospective caregiving were engaged.
- Each of these uses has been challenged by DHS according to recent dialogue with an Oakland County DHS worker.
- The caregiving contract clarifying caregiving by family members in the home remains valid.

Ensure compliance with more recent restrictions on caregiving contracts imposed by Medicaid regulations effective January 1, 2008. Effective January 1, 2008, PEM 405 was amended to clarify and to penalize certain caregiving payments as divestment. The new regulations continue to require the client rebut the presumption of divestment and **do <u>not</u> allow exemption of caregiving payments when**:

- The payment is **prospective**/ for future care;
- Services can only be paid after a written legal caregiving contract, which is signed and notarized (**oral evidence is not sufficient**);
- Contracts outside the home setting (such as a care coordination contract) are barred:

> "At the time services are rendered, the client must not be residing in a nursing facility, adult foster care home, institution for mental diseases, inpatient hospital, intermediate care facility for mentally retarded or eligible for home and community based waiver, home health or home help."

- The regulations now require a **physician's letter** and **formal plan of care** with compensation commensurate with community standards. A general physician's letter is no longer sufficient; there must now be a concerted plan of care under physician review and letter.
- The regulations also bar the legal representative from engaging the caregiving contract with himself (**no self-dealing**).
- Compensation, rent and reimbursement for costs must now be clarified and verified as **commensurate with community costs**. The regional Area Agency on Aging can offer that verification.

6. Gifting issues with federal gift tax reporting and tax apportionment.

- **A summary of the current federal gift tax exclusion and lifetime gift exemption.**

A completed gift from a title change results in the imposition of federal gift taxes to the extent the gift exceeds the annual gift tax exclusion (currently $13,000 per beneficiary per year). Only spouses who are U.S. citizens are accorded an unlimited marital deduction for that gift.

For most individuals, the excess beyond $13,000 merely reduces their $1 million lifetime gift tax exemption and the relevant estate tax exemption at death (currently $3.5 million) with no actual tax due. Although often honored more in breach rather than compliance, filing of a gift tax return is required. The main gift tax problem with real estate transactions is the significant value of the gifted interest.

> ***Practice tip:*** **Keep your eye on estate and gift taxes even with the small estate**. For individuals wealthy enough to incur gift tax during lifetime or estate tax at death, such title changes may create a significant, unanticipated tax burden. It may even force a sale of the house if there are not sufficient liquid assets to pay the tax. Beware of windfalls from inheritance, lawsuit settlements or even lottery winnings increasing the size of an otherwise small estate.
>
> **Example involving inadvertent gift tax consequences:** Wealthy client adds her sister's name to the lake cottage title as joint tenant with rights of survivorship. Cottage is worth $300,000. Again, there is a completed gift of 50% of the value of the property or $150,000 absent proof of sister's contribution. Because the gift exceeds the $13,000 annual exclusion, client must file a gift tax return Form 709 for the tax year of the deed transaction. Client's $1 million lifetime gift tax exemption is debited by $137,000 (the amount beyond the $13,000 annual exclusion). Client and sister ultimately see that other forms of estate planning would work better on handling the cottage. Sister's name is removed. Removing sister's name triggers similar gift tax reporting and unnecessary loss of sister's lifetime gift tax exemption.

- **Remember: gift tax registration of the title transfer is necessary even for a small estate.**

Regardless of whether the gross estate is large enough to incur estate tax, a gift tax return Form 709 is required for transfers exceeding the gift tax exemption (currently $13,000).

Filing of a gift tax return is conclusive evidence of intent for a gift. In fact, the failure to file a gift tax return registering the gift of the house interest with a title transfer is often used as evidence of the fact that the grantor did <u>not</u> intend to make a gift in the first place. Probate judges have used the failure to file a gift tax return as an item of corroborating evidence that the grantor did not intend to make a present gift, but rather had conducted a quitclaim deed as a probate avoidance device.

- **Consider tax apportionment complications.**

Problems with payment of gift, estate and generation skipping taxes are compounded by tax apportionment issues if there is no written estate plan or if there are other beneficiaries other than the recipient of the house taking shares without apportionment of any estate tax.

7. ***Property tax issues with "uncapping" and loss of homestead exemption.***

Probably the most immediate and costly issue with transfers of ownership involve inadvertent "uncapping" of the tax assessed value for property taxes. Proposal A of 1994 constitutionally limited increases in annual property tax assessments to 5% or the inflation rate, whichever is less.

Over time, for people in who have remained in their homes, the gap between the taxable value and assessed value has widened. When property is deemed to be "transferred," the property tax assessed value would then be adjusted to current value (the state equalized value or "SEV").

- **Lower real estate values still mean higher property taxes . . . Huh?**

One of the problems of Proposal A is that when it was passed legislators did not address the situation of a ***declining*** Michigan real estate market. Even with the decline in assessed values, the gap between taxable value and assessed value often remains. Because of this, property owners have seen ***an inflationary increase in property taxes*** even if their assessed values have gone down.

> **Example:** This year the City of Farmington Hills decreased the SEV or assessed value of property by an average of 11.2%. A property previously assessed at $100,000 is now $89,800. If, however, the tax assessed value was only $85,000, there would be no decrease in property taxes.
>
> In fact, there is an ***increase*** in property taxes because the state of Michigan set the inflation rate for 2009 assessments at **1.044 or 4.4%.** This is the highest inflation rate since Proposal A went into effect in 1995 and is the result of higher gasoline and food prices which occurred in the time period for which the CPI was calculated.

- **The most serious cost with property taxes remains "uncapping" upon a deemed "transfer" of ownership.**

Beware of certain deed "transfers" which traditionally have uncapped property taxes. These transfers which inadvertently "uncap" property taxes can make the house prohibitively expensive to keep. Consider this summary of rules under MCL §211.27 and the "Transfer of Ownership and Taxable Value Uncapping Guidelines" of the Michigan Dept. of Treasury:

1) **Adding a new tenant-in-common or removing an original tenant-in-common partially uncaps in proportion to the co-tenant's interest.**

   Example: Mom simply adds son's name to deed. Tenancy-in-common is presumed. Property taxes uncap as to son's presumed one-half (½) interest. Mom's one-half (½) interest remains capped until the transfer of her interest upon her death.

2) **Transfers at death of the original owner to the heirs, devisees, beneficiaries or remainderperson result in full uncapping, unless the transfer is to the surviving spouse.**

   The uncapping typically occurs at the time of deed transfer. However, per the Guidelines, it is possible for uncapping to occur when the distribution process has not advanced in a timely manner and the heir had dominion over the property.

   Example: Upon death of both parents, son is aware property taxes will uncap for their home. He moves in. He keeps the home in their trust for five years after their death. City discovers his control. Property taxes uncap back to date of second parent to die.

3) **Transfer to a trust with a sole current beneficiary other than the original owner or spouse results in full uncapping.**

   Example: Mom needs nursing care and transfers her home to a special needs trust for the sole benefit of her son with a disability. The whole property tax uncaps.

4) **Transfer of more than 50% of an interest in an LLC or partnership results in full uncapping.**

   Example: Mom and Dad own home providing care for their child with a disability and other residents with disability who all rent the home. To shield from liability, they hold their interest in an LLC. Mom and dad both die. The whole property tax uncaps even if title remains in the LLC.

- **Consider this summary under the MCL§211.27 and the Guidelines of "exempt" transfers, which do <u>not</u> uncap property taxes.**

1) **Adding new joint tenant does not result in any uncapping as long as the original owner remains on title.**

   Example: Mom simply adds son's name to title, but as "joint tenant with full rights of survivorship." No uncapping occurs.

2) **Removing a joint tenant does not uncap as long as an original joint tenant remains on title.**

   Example: Son's name is then removed, mom's name as original joint tenant remains. No uncapping.

3) **SIGNIFICANT CHANGE: Transfer to a joint tenant who was not an original owner no longer necessarily results in uncapping.**

   Example: Mom and dad add son's name to deed as "joint tenant with full rights of survivorship." Dad dies. Mom removes her name, leaving son as sole owner. Prior to 2007, the property taxes would have been fully uncapped following State Tax Commission (STC) Bulletin No. 16 of 1995.

   A fundamental change in interpretation occurred, however, with *Moshier v White Water Twp.*, 277 Mich App 403. (2007). Under the example detailed above, the Court of Appeals ordered the "re-capping" of property taxes. The surprising element was that the son who became sole owner was not the original owner with his parents.

   This interpretation is different than that offered in the Guidelines and the 2005 STC Bulletin. The Appellate Court in Moshier noted that those guidelines arising from STC Bulletins are not binding law.

   The interpretation of this case remains unclear.

   The Michigan Townships Association advises this as the rule of law established by *Moshier*:

   Where at least one of the persons involved in a transfer between joint tenants was a joint tenant at the time the joint tenancy was originally created and has remained a joint tenant since that time, ***a transfer to a joint tenant who was not an original owner of the property is exempt from uncapping*** under MCL 211.27a(7)(h) [emphasis added].

   Practice tip: surviving children as joint tenants who have been "uncapped" due to transfer from parents during lifetime or at death may be able to prevail in obtaining refund of excess property taxes paid due to mistaken "uncapping". Beware that the legislature may close this loophole.

4) **Qualified agricultural exemption and [NEW] qualified timber property exemption.**

   When a home is located on a farm, and the use of such property is devoted more than 50% to qualified agricultural uses, there is no uncapping on transfer of ownership to a new owner. The new owner must file with the assessor and record an **Affidavit Attesting that Qualified Agricultural Property Shall Remain Qualified Agricultural Property**. The owner is also entitled to an 18 mil rate reduction for the school operating costs of property taxes (similar to the homestead exemption).

A similar procedure exists for the new exception for Qualified Forest Property passed by the Public Act 378, 379 and 380 enacted in September 2006. This is an opportunity for owners of smaller forestland parcels in Michigan, but unlike the qualified agricultural property exemption, it does not allow a building structure on the parcel. Qualified timber property of no less than 20 acres would have to split from the residence for this exemption to apply.

- **Carefully consider the <u>homestead</u> <u>exemption</u>.**

Attorneys must also carefully navigate the homestead exemption law and reporting requirements. This exemption reduces property tax rates by 18 mils or $1,800 per $100,000 valuation.

Consider the disparate impact of family caregiver arrangements on the homestead exemption per excerpts from the "Guidelines for the for the Michigan Homeowner's Principal Residence Exemption Program" published by the Michigan Dept. of Treasury:

1) The homestead exemption is not removed due to inability to return home because of ***nursing home*** care, unless the home is rented.
   Per the Guidelines, claiming a property tax credit for the portion of nursing home's property taxes <u>will</u> <u>result</u> in loss of homestead exemption.

2) The homestead exemption is removed upon move to ***assisted living*** where there is "no expectation to return home". Evidence of "no expectation to return home" most likely would be a change in driver's license, voting registration, bills, etc. per the Guidelines.

3) Rental of less than 50% of a home still allows for 100% homestead exemption. Thus, if parent moves into caregiver child's home under a ***caregiving rental agreement***, it does not result in loss of homestead exemption as long as mom does not occupy more than 50%.

4) ***Co-ownership arrangements*** of a child with a parent do not cause a loss of the full homestead exemption for either the child or parent's respective residences as long as the residence remains the principal residence of the parent, irrespective of occupancy by the children.

5) If mom constructs a separate entrance without link to common living area to child's home (***"mother-in-law's quarters"***), it will cause a loss of homestead exemption for child.

6) A recent Michigan Property Tax Act extends the homestead exemption (and qualified agricultural exemption) to a ***special needs trust***. The sole beneficiary of that trust must be a person who is totally or permanently disabled. As long as the beneficiary is the main resident (occupying more than 50% as her principal residence), a full homestead exemption should still apply per the rules discussed above.

7) No homestead exemption exists for a ***limited liability company*** ("LLC") – a crucial factor for homes renting to persons with disability. Unlike other areas of property tax law and income tax law, which ignore the company and apply "pass through" tax treatment to the member the same as a sole proprietor, placing title in an LLC removes the homestead exemption. This applies even if the member of the LLC occupies the property as his or her principal residence.

   This loss of the homestead exemption has the greatest impact for ***Semi-Independent Living Program residences ("SILP" or "SIP" homes)***, generally owned by a special needs trust. In such instances, the homestead exemption otherwise accorded to a special needs trust will not apply if the special needs trust holds the house in an LLC. The advantage of the LLC is limiting liability involved with renting the house to persons with disability. To avoid loss of the homestead exemption, some persons choose to hold the house title directly in the special needs trust. They then pursue more liability insurance, foregoing the personal liability protection of the LLC.

8) Recent legislation now allows ***two homestead exemptions*** to be claimed when the property owner remains a Michigan resident and is unable to sell their prior principal residence. MCLA Sec. 211.7cc(5).

9) An occupant (as a caregiver child) who receives the home upon the death of the parent can establish a homestead exemption for herself ***as of the parent's date of death*** by filing a Form 2368 with the assessor.

10) A ***life estate deed*** or ***"Lady Bird" deed*** does not result in the loss of the homestead exemption as long as the life tenant maintains the house as his or her principal residence.

11) ***Deeds to and from a trust*** do not cause loss of the homestead exemption unless none of the current beneficiaries occupy the property as their principal residence. The current beneficiary or beneficiaries who occupy the property as their principal residence then claim the homestead exemption.

8. Real estate transfer taxes upon "purchases" of residence.

If the consideration paid for the transfer of the residence title is $100 or more, payment of State and County transfer tax is required.

Rate of County tax - $.55 for each $500 or fraction thereof
Rate of State tax - $3.75 for each $500 or fraction thereof

This impacts the following situations with family caregiving arrangements:

- Child asserts she **"earned" ownership** in the house for caregiving duties in probate litigation, thus triggering sales transfer tax consequences and earned income tax consequences for such **"consideration"**.
- Mom **invests in caregiver child's home** for her accommodations and co-residence. To prevent implications of gift to child, Mom's name is added to title as joint tenant. Child receives payment for the improvements.

9. *Capital gains tax concerns upon sale of the residence.*

Consider effects of title on "step up" in basis. Certain lifetime transfers involving the house can cause significant capital gains taxes when the new owner sells the house. Even with long term capital gains tax rates currently at a historically low rate of 15%, such taxes can far exceed the cost of probate.

Capital gains taxes are measured from the homeowner's adjusted basis (what they paid for the home and capital expenditures thereafter). Title transfers upon the death of a homeowner normally result in the forgiveness of capital gains tax because of the "step up" in basis at death. IRC §1014(a). Certain lifetime transfers do not result in a "step up" in basis, but rather carryover the original owner's basis to the new owner. IRC §1015(a).

An **outright transfer to a new owner** (as an adult child) will result in **no step up in basis** upon the death of the prior owner**.**

A **transfer as "tenant-in-common"** will only result in **partial step up in basis** for the original owner's share upon the original owner's death**.**

The following lifetime transfers will still result in a **full step up in basis** upon the death of the original owner:

- **Joint tenancy by right of survivorship deeds** where the entire value of the property is included in the estate of the original owner for estate tax purposes. IRC §2036 pulls back the entire value of a transferred interest into the estate of the grantor who retained a life interest. The effect of the retained life interest is punishing for estate taxes, but has the effect of a full step up in basis. This same principal should apply whether the original owner's estate exceeds the federal estate tax threshold or not.

- **Life estate deeds and "Lady Bird" deeds**, which due to the retained life estate of the original owner, allow for a full step up in basis under IRC Sec. 1014(b)(9).

- **Testamentary transfers pursuant to a living trust or Will.**

Consider special applications of the capital gains tax exclusion under IRC Sec. 121. When a homeowner has resided in the home as his or her principal residence for at least two of the past five years, a single homeowner can exclude up to $250,000 of capital gain upon sale from taxation. A married couple can exclude up to $500,000.

When care issues are involved, the capital gains tax exclusion has these applications:

- Even if there is no step up in basis, the same exclusion applies to the new family member who owns and resides in the home for at least two years.

- A special exception to the two year requirement exists for individuals who need to move to a nursing home. If during the preceding five years the individual resided for at least one year in the principal residence, the individual will be eligible for the exclusion. In addition, there are hardship rules if this test cannot be met.

10. Estate recovery concerns with Medicaid.

Long-awaited estate recovery -- adopted in a limited format, not yet implemented and currently REJECTED by the federal government.

One of the main concerns in handling the house is loss due to a lien under Medicaid estate recovery for payments made by Medicaid.

After a marathon session last September, Michigan Public Act 74 established the estate recovery program for Medicaid effective September 30, 2007. Michigan was the last state to adopt this very unpopular program and it did so reluctantly. If it had not acted Michigan stood to lose its federal Medicaid funding, close to $5 billion. The limited program as passed by the state legislature has not ever been implemented. Just last fall the federal government REJECTED Michigan's program, which eventually will send our state government back to the drawing board.

The current (yet unimplemented) program allows Michigan the right to collect past Medicaid payments from an individual's estate. Contrary to the original bill pending in Summer 2007, the Estate Recovery law limited itself to "probate only" assets. There is word, however, that a stricter Estate Recovery law may be in the works.

Here are current specifics of the Estate Recovery program[1]:

- Recovery is run by the Michigan Department of Community Health (MDCH) to recover from Medicaid recipient's estates whatever benefits it paid for the recipient's long term care.
- Recovery applies only to "long term care" Medicaid benefits which are nursing home care or home and community-based services (MI Choice). It also applies to payments for hospital and prescription drug services, but only when under the "long term care" Medicaid benefits described above. It is limited to persons over age 55 or person who are permanently institutionalized, regardless of age.
- Recovery is only retroactive for Medicaid recipients (and their subsequent annual renewals) who became eligible after the date of adoption, September 30, 2007.
- Recovery is currently limited to the Medicaid recipient's ***probate*** estate (property held in the recipient's name only at death). Each state can define by law what is included in a probate estate. States have the option of also seeking recovery against property in which the recipient had an interest but which passes outside of probate ("enhanced estate recovery"). Michigan chose to only allow the recovery against property and assets which pass through a probate proceeding. It is unclear whether Michigan will later seek to expand estate recovery beyond probate assets.
- Jointly held assets, assets by beneficiary designation or transfer on death designation, assets in a living trust and life estates all currently pass without estate recovery under the Michigan law.
- Given the rules for Medicaid eligibility, the only property of substantial value that a Medicaid recipient is likely to own at his or her death is a home.
- The home is exempt from estate recovery if it is equal to or less than 50% of the average price of a home in its county as of the date of the Medicaid recipient's death.
- The home is also exempt if it is the primary income-producing asset of survivors, as a family farm or business.
- The home is also exempt from estate recovery if "hardship" exists. Deliberate estate planning methods diverting assets creates a rebuttable presumption that no hardship exists. This "hardship" exemption remains undefined and unclear in procedure.
- Michigan only allows for liens to be placed after the death of the Medicaid recipient.
- Recovery efforts on the lien cannot begin until after the death of the recipient and certain occupants of the house, detailed below.
- Recovery is not yet "implemented" with systems and regulations by the MDCH. As a practical matter, estates of deceased Medicaid recipients who became eligible after September 30, 2007, yet have closed the estate administration will be difficult to lien.
- Recovery efforts must be delayed if any of the following persons continues to reside in the house:

[1] The summary of estate recovery incorporates commentary received from David Schaltz, Esq. in fall 2007.

- The surviving spouse;
- A **child** of the deceased who is **under 21** years old or who is **blind** or determined "**disabled**." Disability determinations are made by the Social Security Administration;
- A "**caretaker relative**" who was residing in the home for at least two years immediately preceding the Medicaid recipient's entrance to a nursing home and provided care which otherwise would have required nursing home care; and
- A **sibling** who resided in the home for at least one year immediately before the Medicaid recipient's admission to the nursing home.
- When recovery is delayed due to persons residing in the home described above, it is unclear how Michigan will pursue their estates.
- Implementation by MDCH must involve a system of tracking assets, policies and procedures, approval by the federal government and written guides to Medicaid applicants about the program and about the hardship exemption process.

How much would the program ultimately save if implemented? The Governor's Fiscal Year 2007-2008 estimated $10.0 million gross, but only $4.6 million net yearly savings. This conforms with the national average of net recovery, which is only one tenth of one percent of the Medicaid budget ($4 million out of $4 billion costs in Michigan*)*. It must be implemented, however, for these projections to become reality.

11. Employment and income tax issues.

Legal scrutiny of the employment and income tax issues with payments to caregivers invites a whole host of complications. Through the years the IRS has set forth as many as twenty factors in determining whether a caregiver is an employee or an independent contractor.

The IRS's Employment Tax Handbook now lists three factors:

- Behavioral control
- Financial control, and
- The relationship of the parties.

Unless caregivers are hired or paid through an agency, they usually are classified as employees. The determination of an employment relationship is clarified in IRS Publication 926, "2009 Household Employer's Tax Guide".

Although caregivers who are spouses, children under age 21 and parents are exempt as "employees", ***the IRS considers payments to adult children over $1,700 as taxable employment relationships***.

Table 1 of IRS Publication 926 lays out these employment tax requirements:

Table 1. **Do You Need To Pay Employment Taxes?**

IF you ...		**THEN you need to ...**
A–	Pay cash wages of $1,700 or more in 2009 to any one household employee. Do not count wages you pay to— • Your spouse, • Your child under the age of 21, • Your parent (see page 4 for an exception), or • Any employee under the age of 18 at any time in 2009 (see page 4 for an exception).	Withhold and pay social security and Medicare taxes. • The taxes are 15.3% of cash wages. • Your employee's share is 7.65%. (You can choose to pay it yourself and not withhold it.) • Your share is a matching 7.65%.
B–	Pay total cash wages of $1,000 or more in any calendar quarter of 2008 or 2009 to household employees. Do not count wages you pay to— • Your spouse, • Your child under the age of 21, or • Your parent.	Pay federal unemployment tax. • The tax is usually 0.8% of cash wages. • Wages over $7,000 a year per employee are not taxed. • You also may owe state unemployment tax.
Note. If neither A nor B above applies, you do not need to pay any federal employment taxes. But you may still need to pay state employment taxes.		

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Actual compliance with these federal employment law requirements most likely is scant. Lauretta Murphy, in her 2007 ICLE Seminar "Care Contracts" summarizes the problems with compliance best:

> Payment intended to compensate a caregiver will probably be treated as taxable income to the recipient. Query whether the payment could be characterized as a "gift" for income tax purposes but "compensation" for Medicaid purposes. Regardless of what attorneys or CPAs recommend, this is exactly how many families will characterize the payments.

The usual excuse is the "bandwagon" argument: no one else is doing it, why should we? The trouble usually occurs when there is conflict over the payment intra-family or even with Medicaid. The trouble also occurs when the CPA issues a Form 1099 for payments to the caregiver, but the caregiver fails to report such income. In both instances, the IRS enters the picture.

The employment tax requirements for an adult child caregiver are best summarized in the same IRS Publication 926 as follows:

Table 2. **Household Employer's Checklist**

You may need to do the following things when you have a household employee.

When you hire a household employee:	☐ Find out if the person can legally work in the United States. ☐ Find out if you need to pay state taxes.
When you pay your household employee:	☐ Withhold social security and Medicare taxes. ☐ Withhold federal income tax. ☐ Make advance payments of the earned income credit. ☐ Decide how you will make tax payments. ☐ Keep records.
By February 1, 2010:	☐ Get an employer identification number (EIN). ☐ Give your employee Copies B, C, and 2 of Form W-2, Wage and Tax Statement.
By March 1, 2010 (March 31, 2010 if you file Form W-2 electronically):	☐ Send Copy A of Form W-2 to the Social Security Administration (SSA).
By April 15, 2010:	☐ File Schedule H (Form 1040), Household Employment Taxes, with your 2009 federal income tax return (Form 1040). If you do not have to file a return, use one of the other filing options, such as the option to file Schedule H by itself.

What is the easiest practical solution which complies with employment tax law?

Request the accountant or a payroll service to assist. A number of services do payroll and/or recordkeeping for families using in-home caregivers. Some of the services offer free advice on-line; others offer full service. Type "nanny taxes" in your search engine and you'll find services, such as paycycle.com, 4nannytaxes.com and breedlove-online.com. Paychex and ADP also provide payroll and tax payment services for in-home caregivers.

What are the general costs for a payroll service?

Per www.buyerzone.com, check fees for an on-line payroll service as Paychex ranges between $0.80 to $2 per check and about $5.00 per pay period. I usually simply coordinate such help with the family's accountant or the bank fiduciary, who can readily handle such payroll issues.

Step#4: Apply the proper legal tools to handle the house in light of these caregiving situations:

Carefully reflect written understandings about caregiving and title arrangements.

Although it is routinely difficult for attorneys to convince clients to commit family caregiving understandings to paper, a set of written rules overcomes misunderstandings, legal costs and unanticipated consequences. Other professionals as the primary physician, geriatric care manager and agency providing care services must assist with such evaluations and understandings for them now to be compliant with Medicaid and SSI regulations.

- The legal documents should define the relationship, costs and payments involving a family caregiver.

- The documents should set expectation management with non-caregiver family and legal representatives on **communications**, **access/visitation** and **accountability**.
- Ensure there is **full consent to payment or gift arrangements** and review the effect on other family relationships (as objections from children who are not involved).
- **Emergency plans** on communications and care during fire, natural disaster should be addressed. Identify **respite care** alternatives at facilities or through home care to prevent caregiver burn-out. Consider alternatives if the care needs intensify. Arrange for **vacations** and understandings. <u>**See**</u> **Exhibit G for Annual Assessments for Plan of Care.**
- Particular attention needs to be made to the **effects discussed above** on: control, creditors, gifting penalties, gift taxes, property taxes, the homestead exemption, real estate transfer taxes, capital gains taxes and estate recovery.
- Ensure **compliance for caregiving payments** to family members for the detailed requirements under Medicaid and employment tax law.
- Identify the relationship as **"at-will"** such that the caregiver may quit at any time, and also be fired by the principal.

Consider the special situations when the exceptions to divestment and estate recovery overlap.

- Pursue **co-ownership arrangements with a caregiver child** either in the parent's home or the child's home when they are able to live together. Be wary of undue influence issues and ensure proper documentation of the caregiver relationship, which is discussed below. Divestment rules – even under the current regulations – do not penalize the transfer of the home to a child who resides in the home and provides nursing care for a period of **two** years as verified by a physician's letter. The same exception exists under Michigan's estate recovery program, but without clarifying regulations.
- Transfer the house to **a blind child or child with a determined disability** or in the form of a **first party special needs trust** under 42 USC §1396(d)(4)(A) if the child herself participates in SSI-type Medicaid.
- Transfer the house to an **adult child under age 21** or a **sibling with an equity interest** in the home who has lived in the home for at least one year.

Ensure specific authority for such gifts exists within the estate plan documents of a person contemplating Medicaid who may in the future have any of these situations. This ensures there is legal authority to carry out such intentions at the time of illness.

Consider removing the name of a chronically ill spouse in most instances.

- The removal of the ill spouse's name will prevent the house going into the name of the spouse who cannot handle title issues.

- The addition or removal of a spouse's name has no impact under Medicaid regulations as gifts between spouses are not considered divestment. Under federal gift tax law, there is no impact because of the unlimited marital deduction unless the donee spouse is not a U.S. citizen.
- Regardless of whether you will pursue Medicaid, ensure a strong Durable Power of Attorney for the ill spouse if possible which grants rights to handle house title and gifting needs to prevent the necessity of Probate Court approval for such actions in the event of incapacity.
- Straight disinheritance of the Medicaid Spouse by the Community Spouse's revocable living trust will most likely be contested more often, especially as the estate recovery program becomes implemented in Michigan. For at least 10 years in other states there have been successful contests by Medicaid in other states of such disinheritance of the Medicaid spouse, even when the Medicaid spouse validly waived his rights to elect against the estate plan.
- Waivers of spousal rights by the Medicaid recipient as a post-nuptial arrangement can be contested for capacity issues, adequacy of consideration and conflicts of interest. As such, we are careful to analyze these issues with the Medicaid recipient. Waivers of spousal rights by others, as pursuant to specific authority in a Durable Power of Attorney – is questionable absent specific court approval.
- While we are careful to ensure capacity and free will of the Medicaid spouse in waiving rights, it is a post-nuptial agreement and is not subject to the same burdens of proof as a pre-nuptial agreement.
- Testamentary Trusts provide a means to protect the security of the house if the Community Spouse predeceases the Medicaid recipient spouse, even if the house needs to be sold. They are basically a special needs trust for the nursing home spouse established through the Community Spouse's Will.
- The Testamentary Trust can be funded from the assets of the Community Spouse's revocable living trust, thus avoiding a probate administration ("reverse funding"). The Will needs only to be admitted in probate court. Testamentary Trusts are merely registered, but not under supervision of the probate court.
- A question remains whether the estate recovery program (if ever implemented) will pursue recovery against the Community Spouse's estate and Testamentary Trust at the death of the Medicaid recipient.
- Most clients choosing this Testamentary Trust arrangement are not bothered by the possibility of estate recovery against the trust; they only care that the house and any other property supplement the security of the nursing home spouse, who would otherwise only be allowed to keep $2,000 in countable assets.

  See **Exhibit A** for a copy of the Spousal Waiver and **Exhibit B** for an example of a Testamentary Trust and "reverse funding" distribution from the Community Spouse's Revocable Living Trust.

Consider a life estate deed or a "Lady Bird" deed for the house, especially when a caregiver child is involved.

- The house is a countable asset if titled within a trust pursuant to both federal and state Medicaid regulations.
- A life estate deed provides a method of transferring property outside of probate like a deed into a revocable living trust, yet keeps the house as an exempt asset under Medicaid. Because estate recovery is currently limited to "probate-only" assets, the life estate deed currently avoids a lien under estate recovery.
- Like a deed titled in a trust, the life estate deed does not result in an uncapping of property taxes until the transfer at the death of the life tenant. In addition, there is a complete stepped-up basis for capital gains taxes at the death of the life tenant, just like a stepped-up basis at the death of the grantor of a revocable living trust
- A life estate deed grants a remainder interest, which is a gift of an interest in the property.
- A life estate deed then presents the following ***complications***:
  1) there is a penalized gift for Medicaid divestment of the value of the remainder interest if Medicaid is necessary during the "look-back" period; and,
  2) the value of the remainder interest changes each year as the life tenant grows older.
- When concern exists about divestment penalty and the need for Medicaid within the "look-back" period, the grantor of the life estate should reserve the right to change the remainder person back to herself. This reservation of a "general power of appointment" ensures there is <u>no</u> <u>completed</u> <u>gift</u> to the remainder person. No completed gift currently means no divestment penalty.
- The life estate deed with a reserved general power of appointment is called a "Lady Bird Deed." This is most likely after President Johnson's wife, perhaps because of use in Texas, but the origination of the prevalent term is unknown.
- The most common use of the life estate deed is with the Medicaid recipient's own home. However, there are many times the life estate deed is used when the parent buys a "life estate" in the caregiver child's home as a method of exempting otherwise countable assets.
- The Lady Bird Deed works best for a single person needing Medicaid.
- There are other options when there is a Community Spouse (as a Testamentary Trust), which make this less prevalent as a strategy when both spouses are alive. When the Testamentary Trust strategy is not desired, then a post-Medicaid strategy for the Community Spouse may be a life estate deed with the child(ren) named as remainder persons.
- The life estate deed and Lady Bird Deed are relatively blunt tools on death disposition and protections compared to the revocable living trust. As such, our preference with single clients is to hold the property in trust until Medicaid eligibility is definitely necessary and the property can no longer be held in trust
- Michigan has now implemented divestment penalties for the purchase of life estates unless actual residency exists more than one year. PEM 405. This new rule required under the DRA punishes this technique when the elderly person has never actually resided in the home.

  Practice tip: Life estates in the relative's home will have particular benefit when the parent moves into the caregiver child's home for a period of at least two years.

After two years of caregiving, the parent's name can be removed without divestment penalty or estate recovery. Caregiving contracts are often necessary to rebut the presumption of divestment and clarify responsibilities on costs. See discussion below on caregiving contracts.

See Exhibit C for an example of a Lady Bird Deed for a single person.

Consider a caregiving contract when a caregiver child moves into the home of the elder person or sibling with a disability.

The Caregiving Contract continues to have legitimacy when there is a caregiver child who resides in mom's home OR when mom goes to live with the caregiver child. It also applies to care by a sibling.   Both uses are very effective to protect the client and honor the costs to the caregiver child. Compliance with stringent Medicaid requirements, detailed above, is essential.

Per the analysis above, the following steps need to be covered for payments to family members not to be presumed divestment under Medicaid PEM 405:

1) A contemporaneous written, notarized contract exists.
2) Payment is prospective and made at the time services were rendered; not boot-strapped for past care.
3) This applies only for care in the home setting (not for care coordination outside the home).
4) The care is under a formal plan of care with physician's review and letter.
5) The agent cannot engage himself or herself (no self-dealing).
6) Payment must be commensurate with community costs.
7) Ensure compliance with the employment tax law, detailed above.

See Exhibit D for an example of a caregiving contract between a parent and child and **Exhibit G** for Annual Assessments for Plan of Care (as supplement for safety, emergency, respite and vacation plans).

Consider a rental contract when a parent moves into the caregiver child's home.

Many times it is necessary for the child caregiver to take parent into his or her home, especially with other family members. Bridging care is often easier and less disruptive to the caregiver's family obligations. In fact, other family members are given the opportunity to "pitch in," learning valuable lessons about inter-generational care.

An advantage of the rental contract is to convert otherwise earned income items subject to ordinary income taxes to passive income, not involving the same employment tax issues.

Fortunately, unless the parent occupies 50% or more of the house, the entire homestead exemption will be preserved.

> **See Exhibit E** for an example of a caregiving lease between a parent and child and **Exhibit G** for Annual Assessments for Plan of Care (as supplement for safety, emergency, respite and vacation plans).

Consider a co-ownership agreement when the elderly parent or person with disability invests significant dollars in the caregiver's home.

Family budgets to pay for mortgages are already strained in the current economic downturn. The elderly parent may intend to assist with costs on paying down the caregiver's mortgage and receiving in exchange an equity interest in the home. This fair market value exchange prevents adverse Medicaid and gift tax consequences.

At the same time improvements to the house can result in higher property tax assessments with current "uncapping" for the full value of the improvement. Insurance and utility costs can also increase. A co-tenancy agreement can clarify management decisions about sharing these costs and buy/sell provisions upon death, placement outside the home (as medically necessary nursing care) or breakdown in the relationship.

A deed titled as "joint tenants by rights of survivorship" will prevent uncapping property taxes upon removal of the contributing parents name after two years of caregiving by the caregiver child. Removing the contributing parent's name after two years of caregiving is exempt from divestment penalties and estate recovery of Medicaid.

To keep balance with estate plan objectives, tenancy-in-common arrangements may be preferred, with the parent's interest held in their respective living trust. In either case, a co-tenancy agreement should clarify the complications of management and buy/sell provisions.

> **See Exhibit F** for an example of a co-tenancy agreement between a parent and child and **Exhibit G** for Annual Assessments for Plan of Care (as supplement for safety, emergency, respite and vacation plans).

Consider a Special Needs Trust planning with an LLC for private group home arrangements for adult child with disability.

Parents wish to buy a residence for their adult child with a disability, whose governmental benefits will share costs of care with other persons with disability. After purchasing and financing the accommodations in the residence personally, the parents intend to rent the premises to other residents with disability to share care costs. To protect the parents against lawsuits for the residential care and premises liability, the parents transfer title to an LLC.

Private care agencies in conjunction with community mental health programs contract directly with the residents to coordinate and to provide care services. The parents ensure that upon both of their deaths, ownership and management of their LLC passes to a special needs trust.

The adult residents pay the LLC rent to ensure their SSI is not affected by receipt of free shelter called "in-kind maintenance and support". There is special scrutiny under SSI regulations for payments by third parties of utilities and expenses of the residence as "in-kind maintenance and support," which can reduce or eliminate the SSI and SSI-type Medicaid benefits.

The LLC protects the personal assets of the parents and ultimately the special needs trust from liabilities involving the care and premises.

No homestead exemption exists with the LLC, as discussed above. The higher property taxes, however, are deducted from rental income, mitigating this cost.

The special needs trust ensures that means-tested government benefits are not affected by the rental income necessary to pay for the costs of the property. In addition, the special needs trust ensures that sale of the residence at a later date will not affect the government benefits of person with the disability.

This same protective planning can occur by direct ownership by the special needs trust, but with only limited creditor protection from claims for injuries of residents on the property. As discussed above, this preserves the homestead exemption for property taxes. In this instance, pursuit of extra liability insurance is recommended.