Farm Management

To gift or not to gift your assets

Farm & Family

BY SCOTT P. MILLER

Key Points

- Study long-term care, compare costs, review income streams.
- Buying long-term care insurance could be an option.
- Gifting assets is also an option, but explore tax limitations.

IN discussions with clients about issues surrounding aging, there's an issue that clients frequently bring up: "If I end up needing long-term care, I'll just gift my assets away."

Long-term care fears seem to be at the forefront of concerns for many clients. The good thing to know is there are things you can do to leverage the risk that the Department of Human Services will end up as the primary beneficiary of your estate. Let's examine what a typical analysis surrounding this issue looks like.

Can you pay?

Before even beginning to discuss the necessity of gifting assets, we first need to analyze the client's ability to pay for care. Occasionally, clients misjudge the amount of income they have to cover the cost of a nursing home stay. In Minnesota, the average cost of care in a semi-private room is between $78,000 and $84,000 per year. On its face, it seems an impossible financial burden.

Let's consider the scenario involving Bob and Mary Smith, an elderly make-believe couple who have the following facts: 300 acres of tillable land, two Social Security payments, one pension and $400,000 in IRA or non-qualified invested assets. At $200 per acre, the Smiths have $60,000 in annual rental income. They receive $30,000 annually in combined Social Security income and $6,000 in annual pension payments. Finally, generating a 4% return, their investments provide $16,000 in additional annual income.

The Smiths have a combined income of $112,000 before taxes. If they have no large outstanding debt payments, with the help of minimal principal withdrawals, they could cover most if not all of the cost of care for a period of time. If assisted living or home care would suffice, they are sitting even better.

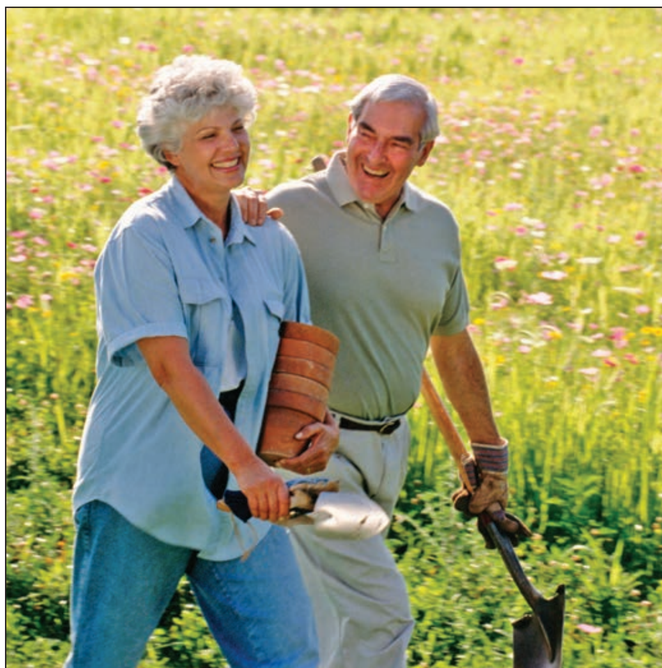
While the Smiths have a large cash flow, that isn't the case for many people. If there isn't sufficient income, it is prudent to explore the possibility of transferring the risk to an insurance company.

The elephant in the room

Many, if not most, people hate life insurance. And if there's anything they hate more than life insurance, its long-term care insurance. Premiums have increased dramatically over the past few years, and there is zero return on investment if you don't end up needing care.

However, there have been changes in the industry to accommodate the increasing number of people needing care. There are now long-term care policies with shared care benefits and hybrid life-LTC policies, among other options.

If you cannot afford to cover the cost of care and protecting your assets is a priority, an insurance policy may be the most logical way to protect against this risk. Discuss your options with your financial adviser. The only thing worse than losing a portion of your assets to an insurance company is losing more of them to pay a nursing home.



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Issues with gifting

For those clients unable to pay for care and unable to obtain or afford long-term care insurance, gifting assets is a viable option. Gifting plans should not be carried out hastily and should be incorporated into your overall estate plan.

The use of an irrevocable medical assistance trust is a way to transfer assets out of an individual's name to accomplish two important goals:

- reduce assets in order to qualify for medical assistance
- protect assets from state recovery

How does it work? In a typical scenario, assets are gifted from the parents to the children. The children create (are the grantors of) an irrevocable MA trust. The parents can no longer receive any benefit from the transferred assets, and in exchange, the assets are not countable toward qualifying for medical assistance.

Too good to be true?

The transferred assets are considered a gift, and gifts are subject to a five-year look back period. This means that the parents will need to be able to pay out of pocket if one of them needs long-term care within five years of the date of the gift. They will be ineligible for medical assistance until five years have passed from the date of the gift.

Gifting has tax implications. From a tax perspective, cost basis follows the gift, so if parents gift highly appreciated land to their children, they also are gifting a low cost basis, which will result in capital gains if and when the children sell the land. If the land generates rental income, that income will need to be reported on the children's tax returns, and they may be in a higher tax bracket than were the parents. Tax implications need to be discussed thoroughly with your tax adviser.

There is a loss of control, too. In making the gift, the parents have given up all ownership rights to the asset. If it is a rental property, the right to income now belongs to the children, and the parents must trust that the children will gift the income back to the parents.

Based on the client's estate planning goals and financial situation, gifting may not be an option, but many times it is. It is important to remember that when considering a gifting plan, it needs to be implemented before crisis strikes because at that point, it may be too late.

Miller is an attorney at law at Miller Legal Strategic Planning Centers, P.A., Tyler. Contact him at comments@millerlegal.com.

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