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What's New in Planning to Protect Your Farm from Nursing Homes and Death Taxes

Farm Bureau Seminar

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What's New in Planning to Protect your Farm from Nursing Homes and Death Taxes

- Last year my talk focused on the tax consequences of planning to protect your farm from nursing homes.
- We looked at the tax consequences under the tax laws on the books last summer.
- And we also looked at what was being considered in Washington that would have impacted that planning.

What's New in Planning to Protect Your Farm from Nursing Homes and Death Taxes

- This year I'm going to focus on new developments.
- The first development is that none of the terrible tax consequences that we discussed last summer were able to get passed by Congress.
- The second is the change in basic planning.
- The third and most important is the impact of increased land prices.

New Developments in Tax Laws

- The most important development in tax law has been that none of those proposed new tax laws were able to pass through Congress:
  - There's no new capital gain tax on gifts during life or at death.
  - The exemption from gift and estate taxes was not reduced to $3.5M or $1.0M.
  - The capital gain tax rate has not increased.
  - Discounts for marketability and minority interests were not eliminated.
  - Section 1031 capital gains tax deferrals have not been reduced.

New Developments in Tax Laws

- But there have been at least two positive developments:
  - The exemption from gift and estate taxes increased on January 1, 2022, to $12.06M. That exemption is available per person. That means that a married couple can now insulate $24,120,000 from gift and estate tax.
  - The second positive development just occurred on July 8. Prior to that date, in order for a married couple to get two exemptions the surviving spouse had to file a federal estate tax return within 2 years following the death of the first spouse. That sounds like plenty of time, but it's not always easy to get appraisals, to get information from insurance companies, and for the surviving spouse to realize that it must be done. But on the 8th the IRS announced that they would allow those returns to be filed within 5 years after the death of the first spouse.

But What Remains the Same

- Unless Congress changes the law, the exemption from gift and estate tax will drop to about half of what it is today on January 1, 2026, a little over $6,000,000.
- The recent increase in land prices puts all farm owners much closer to that amount.

Planning Techniques Impacted by Higher Land Prices

- Accelerate tax planning (current outright gifts, gifts of LLC interests, gifts in trust) because higher land prices put estates closer to that January 1, 2026 reduced exemption amount.
- Revisit equalization plans because more liquidity will be needed to equalize with non-farm heirs.
- Reconsider options to buy at fair market value because farm heirs may not be able to borrow enough or make the payments.
- Look at options to rent because cash rents may increase as land values go up.
- Analyze options to buy on contract to redetermine whether contracts will last too long.
- Gifting plans already in place may not work as increased land values edge closer to the exemption limits (the 1% per year gift of an LLC interest may now be worth more than $16,000).

Solutions to Those Problems

- Buy life insurance (or buy more life insurance).
- Don't tie options to full fair market value, but instead consider 90% of fair market value (the actual net after sale expenses) or possibly even less if it's still fair to all because the farm heir has to work to get their value.
- Decide on a farmland division plan before death so that heirs can sell to each other or work out another plan without all of the land being subject to a partition lawsuit.
- Make substantial gifts to use up today's exemption before it drops on January 1, 2026.
- Hope that Congress eliminates the exemption reduction.
- Insert language in planning documents suggesting to trustees and personal representatives that trusts and estates borrow funds to pay non-farm heirs and then distribute land subject to debt (if it works).

Developments with Long-Term Care Insurance

- A positive development in this area has been the availability of hybrid policies.
  - These policies combine a long-term care benefit with a life insurance death benefit, or possibly with an annuity product.
  - The advantage of this arrangement is that if the policy benefits aren't used for long-term care, they may still be payable to the family at the death of the insured.
  - Another advantage is that sometimes the underwriting is more like that for life insurance which can make the policies available to more people.
  - A negative development in this area has been the continuing decline in the number of companies that issue long-term care insurance and the financial difficulties incurred by some of the companies that remain.

Developments with Medicaid

- There have not been major changes in the Medicaid rules.
- But let's review the Medicaid basics.
- And let's look at how increased land prices impact planning for Medicaid eligibility.

Medicaid Basics

- Medicaid pays the nursing home bill after all of your resources are gone (not normally the plan) or you've paid what you planned to pay.
  - It's never too late to plan.
  - Medicaid is available for home care and assisted living in limited situations.
  - Eligibility for Medicaid requires satisfaction of both an income and an asset test, but the asset test is more difficult to satisfy.
  - There is a 5-year lookback rule that applies to major gifts to anyone other than your spouse.

Medicaid Basics

- 5-yr Look-back Period
  - Gifts made in the last 5 years before applying for Medicaid create a period of ineligibility from Medicaid benefits.
  - The length of the ineligibility period relates to the amount of the gift and the cost of nursing home care. The State says that nursing care currently costs $7,167 per month - 405 IND. ADMIN. CODE 2-3-1.1(g). But this amount was $6,873 prior to July 1st.
  - A gift of 100 acres worth $8,500 per acre for a total gift of $850,000 creates over 10 years of ineligibility. But that same gift of 100 acres now worth 30% more at around $11,000 per acre for a total gift of $1,100,000 now creates over 12 years of ineligibility. That's even with the increase in the eligibility divisor.
  - The ineligibility period begins at the time of the Medicaid application, when the applicant is in the nursing home and otherwise eligible for Medicaid - 405 IND. ADMIN. CODE 2-3-1.1(c), not when the gift is made.
  - "Otherwise eligible" means other assets reduced to $2,000 (individual) or $3,000 (couple).

Medicaid Basics

- More information can be found at Indiana's website: http://in.gov/fssa/index.htm

- The Indiana Health Coverage Program Policy Manual can be found here: http://in.gov/fssa/files/Medicaid_Combined_PM.pdf

Medicaid Scenario #1

- One spouse is in nursing home, and one is at home
  - Step 1 – spend down countable resources as of snapshot date 1st day of at least a 30-day stay in a health care facility) to the lesser of $137,400 or ½ of total countable resources (but not less than $27,480) - 405 IND. ADMIN. CODE 2-3-14(c)(3) (2016).
    - Non-countable Resources:
      - Income-producing real estate, Home, Furnishings, Vehicle, Funeral, Business Assets, IRA of non applicant spouse (for a limited time)
    - Spend Down Options:
      - Funeral Home (*Ind. Family & Soc. Servs. Admin. v. Culley*, 769 N.E.2d 680 (Ind. Ct. App. 2002))
      - Home Repairs
      - Immediate Annuities
      - Nursing Home Costs
      - Farmland/Equipment/Debt Reduction (mortgage or operating line)
      - Can't make gifts to kids to spend-down

Medicaid Scenario #1

- One spouse is in the nursing home, and one is at home (continued)
  - Step 2 – transfer assets to spouse at home, but there will be income tax on IRA transfers and loss of basis step up at nursing home spouse's death
  - Step 3 – revise estate plan of spouse at home to reduce any benefit to the nursing home spouse in case the spouse at home dies first and possibly to include an irrevocable trust to insulate their assets against their long-term care costs.

Medicaid Scenario #2

- Surviving spouse is in the nursing home or both spouses are in the nursing home
  - Must spend down resources to $2,000 or less for surviving spouse or $3,000 or less for a couple.
  - Remember that monthly income still goes to the nursing home.
  - There is no spouse so no transfer possibility or spend-down.
  - But some assets do not count against Medicaid eligibility, such as income-producing real estate (farmland).

Medicaid Scenario #2

- But the farmland is still at risk, even if it doesn't prevent Medicaid eligibility.
- Following the Medicaid recipient's death, Medicaid's resource recovery rights allow it to recoup all advances against the recipient's remaining assets.
- Might not be as bad as expected because monthly income goes to nursing home and Medicaid pays at a different (possibly lower) rate than private pay.

Shielding Farm Assets

- Four techniques used to shield farm-related assets from the future costs of long-term care
- Outright gifts
- Gifts of land with a retained life estate
- Transfers to irrevocable trusts
- Transfers to a limited liability company (LLC) and then gifts of the interest in the LLC

However, none of these can be easily reversed or changed

Outright Gifts

- Good:
  - Completed with only a deed
  - Less likely to be affected by future law changes
- Bad:
  - Takes the income with it
  - After an outright gift there is no right to live in the principal residence
  - Removes control of the asset from the donor (who can rent and on what terms)
  - Carries with it the donor's basis and there is no basis step up at the donor's death

Gifts of Land with a Retained Life Estate

- Good
  - Completed with a deed
  - After the gift, the donor:
    - Retains the income from the land
    - Retains the right to live in the home
    - Retains control of the decisions about the land
  - Those who receive the gift get a basis step-up at the donor's death
  - There is no Medicaid estate recovery on the remainder interests
- Bad
  - If the land is sold, those who received the gift are entitled to a portion of the sale proceeds (and must sign the deed)
  - If the land is used as collateral, those who received the gift must sign the mortgage (but not the promissory note)
  - Restricting subsequent transfers by those who received is not easy (their divorce can cause major problem)
  - The exemption from resource recovery is not recognized in all states

Transfers to Irrevocable Trusts

- Good:
  - The income from the land and the right to live in the home can be retained (unless there are VA benefits).
  - If the income is retained, there can be a basis step-up
  - The trust can be used to control the succession of the farm after the donor's death.
  - If the land is sold, the sale proceeds stay in the trust.
  - While the land is in/owned by the trust, those who will eventually receive it cannot transfer/lose/mortgage it.
- Bad:
  - The settlor no longer controls the asset.
  - Costs more than simple gifting options.

Transfers to a Limited Liability Company (LLC)

- Good
  - Insulates farm assets against outside liabilities, such as accident liability or nursing home cost.
  - Also can be used as part of the overall farm succession plan or for death tax reduction planning
  - May preserve control and income for the one setting up the LLC
- Bad
  - LLC's can be more complicated and expensive than irrevocable trust.
  - LLC interest of owners attachable by creditors/ex-spouse/ Medicaid estate recovery, but outsiders do not get right to vote.
  - Future gifts of an LLC as part of a succession plan can create new gifts that count against Medicaid eligibility.

Reducing Risk if Minimal Planning Done

- Techniques for reducing the risk to the farmland.
  - Long-term lease can preserve opportunity to farm at a reasonable rental amount.
  - Should be in fair market value range with typical lease provisions.
  - But lease payments will go to nursing home.
  - Land itself is not protected from Medicaid recovery.

Reducing Risk if Minimal Planning Done

- Techniques for reducing the risk to the farmland.
  - Long-term sale contract can preserve land at a reasonable purchase price.
    - But purchase price payments will go to the nursing home.
    - Payments remaining at death are subject to estate recovery by Medicaid-IHCPPM 4650.00.00, et seq.
    - The duration of the land contract must not exceed the life expectancy of the seller, or the principal will be a countable resource.
    - There will be tax on the capital gain from the sale.

Reducing Risk if Minimal Planning Done

- Techniques for reducing the risk to the farmland.
  - Consider granting an option to purchase, exercisable following death of Medicaid recipient.
  - Price can be locked in but should be within fair market value range.
  - Must be payment for the option (but can be similar to solar/wind power options).
  - Preserves basis step-up because sale not complete until after death if option exercised (but check with accountant).
  - Preserves purchase opportunity for farmer, but payments still subject to recovery.

Reducing Risk if Minimal Planning Done

- Techniques for reducing the risk to the farmland.
  - Contribute to an LLC.
  - LLC Manager can control farming arrangement.
  - Multiple contributors becoming Members is better.
  - Operating Agreement of LLC will apply to Medicaid if there is resource recovery.
  - Proceeds from buyout of Medicaid's recovery interest still go to Medicaid.

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