THE HUGHES LAW FIRM

A PROFESSIONAL CORPORATION

1974

"THE LIFETIME BULLETPROOF TRUST™

THE SECRET TO SHIELDING YOUR HOME AND LIFE SAVINGS FROM MEDICAID AND LONG-TERM CARE COSTS OF $8,000 OR MORE PER MONTH, <u>WITHOUT</u> HAVING TO BUY LONG-TERM CARE INSURANCE, AND <u>WITHOUT</u> HAVING TO GO BROKE IN A NURSING HOME!"

As we all know, we are living much longer than our predecessors. We run the risk of being disabled for a longer period of time before we pass to the next dimension. We also risk spending $8,000 per month, give or take 10%, to pay for care during our disability if we don't have family members close by who can pick up the burdens of our long-term care.

We all know that long-term care insurance has been around for quite a few years now, but only about 10% of folks who should be buying it are actually writing checks for it. Most of us resist buying LTC insurance because we naively believe that it's always somebody else who's going to be stuck with a long-term care problem, or – even if we are pretty realistic about it – we just don't want to spend what we perceive to be outrageous premiums for the coverage. It's just human nature.

Be that as it may, there's about a 50% probability that we're going to need some type of long-term care before we die. Ignoring that very discouraging percentage is probably not smart. Knowing your options, however, is the key to making some moves that will keep you from going broke in a nursing home.

This paper is intended to educate you on a planning technique that many folks are using today. While it may <u>not</u> be appropriate for you, at least you will learn what's out there as an alternative to purchasing high-priced long-term care insurance.

I will take you through a conversation I had with John and Mary Love on this topic. John and Mary are real clients, but, of course, I have changed their names to protect confidentiality. You're going to learn, as they learned, the ins and outs, pros and cons, risks and rewards, and the various nuances associated with planning through the use of our Lifetime Bulletproof Trust™.

So, sit back, relax, and spend the next few minutes learning – through John and Mary Love's experience – how you can bulletproof your home and life savings from the devastating costs of long-term care.

Background

John Love is 74. Mary Love is 69. They have been married for a little over 15 years. They were each married before, but lost their spouses to cancer. John has one daughter by the name of Alice, who has two children of her own. Mary has one son by the name of Bart, who has two children of his own.

John's daughter, Alice, is challenged with multiple sclerosis, a difficult "gambleholic" husband by the name of Rusty, and an autistic nine-year-old son by the name of Danny.

Mary's son, Bart, is a brilliant and well-educated petroleum engineer, but is an alcoholic who chooses not to change his ways. He has a new wife by the name of Lola, who is not the mother of his two children.

John and Mary want to make certain they leave the lion's share of their combined estate to their children and grandchildren, but don't want to buy long-term care insurance. They came to one of my workshops where I talked about long-term care planning with the Lifetime Bulletproof Trust™. They came in for a complimentary meeting a couple weeks later to talk in more detail. Here's how that conversation went.

Our Conversation

Richard: Welcome. I see here from my notes that you attended my workshop, and have lots of questions about protecting your home and savings from long-term care costs.

John: Yes. We saw your newspaper ad about your seminar and came mainly to find out more about how we can plan in case we end up in a nursing home.

Mary: My mother spent seven years in a nursing home before she passed away. She spent nearly every dime she saved on the cost of her nursing home. I was recently diagnosed with early-onset Alzheimer's, and I don't want what happened to my mother to happen to me or my family. Even if I wanted to buy long-term insurance now, I doubt that any company out there would sell it to me. We need to come up with some kind of a plan.

Richard: You are wise to dig into this issue now. Too many folks ignore the possibility that they could become victims of long-term care costs. There's a huge risk that all of us could need assisted living or nursing home care in the future, even though we all really think it's going to happen to someone else, not us.

John: I'm really glad I went to your class. I had the mistaken impression that Medicare, or at least my Medicare supplement, would pick up the cost of any nursing home bill.

Richard: Don't feel lonesome on that count. Unfortunately, Medicare only picks up the first 20 days of a nursing home stay, and less than half of the cost of the next 80 days. Most Medicare supplement plans will pick up the difference for those 80 days, but after a total of 100 days, you're on your own. Medicare doesn't pay a dime of your care costs past 100 days.

Mary: My mother was paying about $4,000 a month when she first went into the nursing home in the early 90s. When she finally passed away in 2001, the monthly rate was up to over $6,500 a month. What is it now?

Richard: The cost of long-term care varies depending on where you live, the type of facility you're in, and what type of care you actually need. Most facilities will charge between $6,000 and $10,000 per month, with about $8,000 being a fairly predictable average now. With everything going up every year, it's probably not unrealistic to assume that care costs will approach $10,000 per month very soon. Many folks go broke in a matter of a couple of years, if not in a matter of a few months.

Mary: What is the difference between Medicare and Medicaid?

Richard: Medicare, simply stated, is the federal program that pays for most of our doctor and hospital bills after we turn 65. We all get it regardless of our incomes or net worth. Medicaid, on the other hand, is the program that pays for our nursing home bills and certain assisted living bills when we run out of money and can't pay for that care on our own. It is asset and income sensitive, so you can't make too much money or have too much saved to qualify for Medicaid. You have to "spend down" excess resources before you can qualify for Medicaid. In other words, it's not "automatic" like Medicare.

John: I put together a list of our assets for you to review. Would we even come close to qualifying for Medicaid if one or both of us needed long-term care?

	John's Assets	Joint Assets	Mary's Assets
Residence (clear)		$525,000	
Hawaii Vacation Condo		$250,000	
Mutual Funds		$125,000	
CDs		$370,000	
IRAs	$200,000		
Annuities	$ 20,000		$ 30,000
Life Insurance (term)	$ 30,000		$ 20,000
Personal Property		$ 30,000	
	$250,000	$1,300,000	$ 50,000

GRAND TOTAL ESTATE ……………………$1,600,000

Richard: No. The good news is you have way too many assets. The bad news is you have way too many assets.

Mary: What do we actually need to be down to in order to qualify for Medicaid?

Richard: Well, that gets a little complicated, but just for the sake of discussion, the two of you can't own more than your house, the usual personal property, and about $120,000 of other assets. If one of you passed away, the surviving spouse couldn't have more than a residence, personal property, and $2,000 in the bank. When you get down to those levels, Medicaid will step up and pay your long-term care costs. But, be aware that when you're unmarried and you own a home, Medicaid can come back against the value of your home after your death and file a claim against it equal to the amount of money Medicaid paid for your care while you were in a nursing home. Therefore, for unmarried people, even though you can <u>qualify</u> for Medicaid while still owning a home, it's as if Medicaid is only <u>loaning</u> you the money to pay for your care. They want it repaid when you die; they get it by filing a claim against your home <u>after</u> your death. This is what is called Medicaid estate recovery.

Mary: That's pretty tricky of them. I'll bet a lot of people get snookered by that law!

Richard: Frankly, a lot of people get snookered by many parts of this Medicaid law. It's extremely confusing and difficult. Most attorneys know nothing about the Medicaid laws. In fact, there is a very distinct sub-specialty in the law dealing with Medicaid-planning strategies. We have some of the top people in our firm who know the law like the backs of their hands. To know what to do here really does require the counsel of experts. I'll try to help you the best I can so you never have to worry about losing everything if you get sick later on.

John: Based on what you see from our list of assets, and understanding that our total income right now is around $3,500 a month, what do you think we should be doing?

Richard: I'll start out with a simple suggestion which I'm <u>not</u> going to recommend, but I want to keep it pretty basic in the beginning, and then give you more sophisticated ideas as your knowledge increases.

Mary: Thank you, Richard. All this legal stuff makes my head spin. Give it to me slowly.

Richard: I promise I will. First of all, you could simply give away most all of your major assets to your children right now, and get what's called the "five-year clock" running on your gifts.

John: I heard you mention that five year thing during your seminar. I really don't quite get what you're talking about.

Richard: Medicaid will actually allow you to give your assets away so you can qualify for their benefits later, but they won't let you make gifts on Monday and get their help on Tuesday. What Medicaid says is you have to give away your assets five years before you come knocking at their door for help.

Stated another way, when you go to Medicaid for financial assistance, they have the right to look back into your checkbook a full five years from the date of your Medicaid application. What they're looking for – among other things – are gifts. If you made gifts today, and then made an application for Medicaid, say, three years from now, the Medicaid tech working your file would ask for all of your financial records and discover that you made gifts three years ago. Therefore, they would deny your Medicaid application because you violated the five-year rule.

Mary: I've heard that called the five-year look-back rule, right?

Richard: That's right. Medicaid can look back into your records five years to see whether or not you've made any gifts during that time.

John: So, what you're telling us is that if we're going to be making any gifts, we need to get on the stick right now so that we have at least five years behind us before we go to Medicaid asking for financial assistance.

Richard: That's right.

Mary: So, you're saying we could give most, if not all, of our stuff away now to our kids, get the five year clock running, and then we might be pretty close to qualifying for Medicaid if we needed it after the five year period goes by?

John: Wait a minute, Mary. Do we really want to give our assets to our children? Don't forget about Bart and his booze. And, I'm not forgetting my daughter's MS and her gamble-holic husband, Rusty. If we give our assets to our children, we run the risk of them losing everything with nothing left for our emergencies later on down the road. Rusty will probably kick us out of our home!

Richard: I couldn't have said it better. Leaving things outright to your children is a prescription for disaster. While it is possible to get the five year clock running on gifts to children, leaving things outright to them is way too risky. If they get divorced, sued, run into their own healthcare problems, or simply rack up lots of debt, whatever you leave them in your efforts to qualify for Medicaid in the future can be lost overnight. Simply stated, making large, outright gifts to your children is a huge mistake. Leaving things in trust, however, is better.

Mary: From your seminar, Richard, I remember you always talking about trusts. Tell me how a trust works in Medicaid planning.

Richard: Yes, I have to admit, I do spend a lot of time talking about trusts. Trusts are the tools of my profession. I think of trusts like trucks. People and companies use different kinds of trucks for different kinds of jobs. There are dump trucks, fire trucks, pickup trucks, tanker trucks, delivery trucks, you name it; there's a truck for just about any job. When it comes to estate planning and asset-protection planning, there are special trusts that we use to do particular jobs for our families.

Mary: Well, you certainly know that one of our objectives is to pass as much down to our children as possible. However, we want to enjoy what we have during our lifetimes and make sure it doesn't all get eaten up by long-term care expenses.

Richard: That's why I'm going to teach you about a special trust we use called the Lifetime Bulletproof Trust™.

John: Is this different than the revocable living trust we hear and read so much about?

Richard: The Lifetime Bulletproof Trust™ is an <u>irrevocable</u>, not revocable, living trust. It's a different kind of trust for a different kind of job.

John: I understand that you're going to try to protect assets with the Lifetime Bulletproof Trust™, but can't you do that with a revocable living trust?

Richard: That's a great question. The answer, however, is no. The more common revocable living trust is a trust that's been used for years to help families avoid both a death probate and a living probate. It also serves as the springboard for allowing folks to pass assets on down to their loved ones either outright or in asset-protection trusts. Simply stated, a revocable living trust is not effective for protecting our clients' assets from long-term care costs.

Mary: Why is that?

Richard: All assets transferred to a revocable living trust are still, in fact, owned by our clients. That won't work for asset-protection planning. We need to use a different type of a trust – an irrevocable trust – so we can transfer assets out of the ownership of our clients into the ownership of an irrevocable trust.

John: Now you are starting to concern me. Are you suggesting that in order to protect our assets, we have to give up the ownership of them by transferring them to a trust that now becomes the owner?

Richard: Exactly. Although that seems frightening at first blush, the trust provides you with two all-important powers that give you virtual control over the assets you give to it – almost as if you had continued to retain ownership. I'll teach you about these two powers as we move along.

John: Okay. So, we create this trust and transfer those assets we really want to protect into the name of this irrevocable trust, right?

Richard: Right. What assets on your list do you and Mary really want to protect and make certain you can pass on down to your children?

Mary: We definitely want to protect our home, the condo in Hawaii, our mutual funds, and most of our cash savings. We'd also like to protect as much of our IRA money as possible, but I seem to remember you saying during your seminar that it was not a good idea to put IRA money into an irrevocable trust.

Richard: With regard to IRAs and 401(k)s, trusts really can't own those assets while you're alive. You could get the value of those accounts into an irrevocable trust, but you would have to strip the money out, pay all of the deferred income taxes early, and then put the net proceeds into the trust. Most folks, however, don't want to pay taxes any sooner than they legally need to. Therefore, rarely do we ever look at withdrawing money from IRAs, 401(k)s, or other tax-deferred retirement plans when it comes to this type of long-term care planning. Some of our clients do, but not many.

John: We don't want to go on the Medicaid rolls right away, anyway. We're okay with paying for a couple three years out of our own pockets, but we just don't want to lose everything if we are among those poor souls who get stuck in a nursing home for 4, 6, or 8 years. If that were to happen, we'd lose everything. That's why we want to protect the things we talked about a moment ago and leave the rest of the assets on the table for our early care needs.

Richard: That sounds like a great plan. Let me give you a little bit more detail about the Lifetime Bulletproof Trust™. For starters, you actually transfer legal title of your home, the Hawaii condo, your mutual funds, and about half of your savings to the name of your Lifetime Bulletproof Trust™. Just for discussion purposes, let's give that new trust a name that's personal to you two. How about The Love Lifetime Trust?

Mary: That sounds good.

John: OK by me!

Richard: As I've stated several times before, this trust is an irrevocable trust. That means that you will not have the opportunity to terminate it on your own and take back the assets you put in it. In addition, I do not want either one of you to be the trustee of this trust. Think of trustees as managers. I want the manager, or trustee, of your new trust to be whomever you choose, just not yourselves. If you don't like the trustee you've picked, you have the power to remove and replace your trustee whenever you want to. **This power to "remove and replace" your trustee is the first of your two all-important powers.**

John: Could we name my daughter, Alice, to be the trustee of our trust?

Richard: Absolutely. What do you think about that, Mary?

Mary: Well, I certainly wouldn't want to name Bart. I really adore Alice and know she would do a great job, so I have no problem naming her as the trustee of our trust.

John: Why can't we be trustees of our own trust?

Richard: Technically, you can. I simply am a little bit more conservative on this particular count because I don't want things looking too cozy here. If I named one or both of you to be trustees of your trust, I think it simply opens things up to more scrutiny and opportunity for attack at a later time by some judge or case worker who didn't like the fact that you were the trustee and "manager" of a trust that you really don't own.

John: I understand that. I think my daughter, Alice, would be a great choice. We trust her 100%.

Richard: I think trusting your trustee 100% is important. But even if you don't have a 100% trustworthy trustee, you still have another all-important power in the trust that gives you ostensible control over what's in it.

Mary: Let's back up here just a minute. If we die, is this trust going to act like a will and pass the assets in the trust to our children?

Richard: Yes. Trusts are what lots of people call "will substitutes." A trust that you create will always have a provision in it saying where the assets go when you die. Whether you leave your assets outright or in continuing trusts for the benefit of your descendants is a topic we will discuss at a later time. But, for now, accept the fact that this trust will pass any remaining assets down to your descendants in whatever manner and percentage you decide upon later.

John: I'm not liking this idea of the trust being irrevocable. It seems like we won't have any power over what's in the trust. Can we use the stuff that's in it, or ever get any of it out later?

Richard: Absolutely. Let's take your home for example. We will transfer legal title of your home into your new trust. We will then have your trustee execute a separate legal document called a "Use and Occupancy Agreement." That agreement will give the two of you the right to live in your home for the rest of your lives, as long as you continue to pay the taxes, homeowners' insurance, utilities, upkeep, and the like.

Mary: Well, that's reassuring, but that's no different than what we do now.

Richard: Correct. And, just like now, you can live in your house for the rest of your life – even sell and buy others – all without the interference of your children or anyone else.

John: We don't have any mortgage left on our house, but if we did, would we be able to take the interest deduction?

Richard: Yes. Even though you have given the house away to the trust, the Use and Occupancy Agreement would obligate you to pay any continuing mortgage payments. If you make the payments, you get the income tax deduction for the interest paid.

Mary: What if we later want to take out a reverse mortgage or a home equity line of credit?

Richard: That will be difficult to do since the legal title to the property is now in a trust. If you are truly intent on doing either one of those, I would advise against using a Lifetime Bulletproof Trust™ to protect your house. Looking at your list of assets, it would appear that you would never really need to tap into the equity in your home, so doing a HELOC or reverse mortgage doesn't look like something that you would ever want to do. But, as an aside, you could later mortgage your home, but you'd have to remove it from the trust. That would destroy the 5-year plan, though. Not a good idea . . .

John: I believe you're right, Richard. We've got plenty of other sources to tap into if we needed money.

Richard: We also build what we call a **"back door"** into your trust. That means that your trustee can distribute money or property out of the trust with the permission of a third party, called a trust protector. More about the trust protector in a couple of minutes. The "back door" gives you great flexibility. For example, let's say that you had been admitted to a nursing home and had burned through all of your liquid assets to pay for care before the five-year clock had run. Because five years hadn't gone by, we can't knock on Medicaid's door for financial assistance. Your trustee, Alice, can distribute money out of the backdoor of the trust and use it to pay your monthly care costs until such time as the five-year clock runs its course. Once it does, the bleeding from your trust stops, and Alice would then be able to help you file a successful Medicaid application for funds to help pay what could be an $8,000 to $10,000 nursing home bill.

Mary: What if we just wanted to get, say, $50,000 out of the trust to take a world cruise?

Richard: It is possible to do that through the backdoor, but only <u>indirectly</u>, not directly.

John: What do you mean by that?

Richard: The trust is designed so <u>neither</u> of you is a beneficiary. This means that Alice, your trustee, could never distribute money out of the trust <u>directly</u> to one or both of you. That would be a violation of the terms of the trust. The beneficiaries of the trust while you are alive are Alice and Bart. Stated again, <u>you are not beneficiaries of this trust</u>.

John: So, are you saying that Alice could distribute money out the backdoor to herself first, and then turn around and give it to us?

Richard: Precisely. It's a two-step process. Alice can distribute the money out the back door to herself first. She can then, if she chooses, give that money to you, or use that money to pay for your expenses. This way, you are able to get money out the back door of the trust <u>indirectly</u>, not directly.

Mary: That sounds kind of scary. What if Alice took a whole bunch of money out of the trust and put it in her checking account, and then decided not to give it to us or pay our bills?

Richard: That is a very legitimate concern. However, we have protections built into the trust that will prevent abuse. The first protection is, of course, appointing a trustee that you trust. In all of the years I have helped client's prepare these types of trusts, I have never had a child serving as a trustee dishonor his or her parents. Therefore, the likelihood of Alice forsaking you is negligible.

John: Yes, but what if her husband, Rusty, influences her into doing something dishonorable?

Richard: Good question. **That's why we name a <u>trust protector</u> as part of the overall makeup of your trust.** A trust protector is another person we build into your trust to monitor the conduct of your trustee and to watch your backs. Your trust protector can be whomever you choose, including your accountant, your best friend, or perhaps even one of the members of my firm. For example, we have a provision in your trust that Alice cannot make a distribution out of your trust through the back door without first obtaining the written consent of the trust protector. This gives the trust protector both the right to veto any distribution through the back door, and the power to regulate the amount that goes out. Think of your trust protector as the gate keeper who's always looking out for your best interests.

And, as an extra precaution – and for some rather esoteric income tax reasons – we also give you the power to veto back-door distributions. With this double oversight of your trust and what's in it, the chance for abuse is virtually eliminated.

John: That still doesn't prevent Alice from simply keeping the money that comes out of the trust as her own, or using it to buy anything she wants. I'm uncomfortable.

Richard: That's why I build in a second power for you called a "limited testamentary power of appointment," or what I like to call the "hammer." This limited testamentary power of appointment (the "hammer") gives one or both of you the right to change the ultimate beneficiaries of your trust. If you start out with a plan to leave the kids everything 50/50, but Alice decides she likes seeing that $20,000 in her checking account that she moved out the back door, you could threaten to cut her out – or, if necessary, actually follow through with your threat and cut her out – from the balance of the trust property. As soon as she gets wind of this, she won't be able to do the right thing with that $20,000 fast enough! In the many years I have been using these irrevocable trusts, I have never even had to hint at the use of bringing down the hammer. The trustees my clients select have always been 100% honest. But that doesn't mean there won't ever be a first time. That's why I like the hammer. But short of using the hammer, you could simply remove and replace Alice as trustee and put someone else in to do the job. You have the power built into the trust to do this. Remember, this "remove and replace" power is the first all-important power we talked about earlier.

John: If we have plenty of money outside the trust, why would we ever want to get money from the trust?

Richard: That's a great question. Normally, I really don't want my clients to be dipping into the money that we put into the trust. I want the trust to look more like a savings account, not a checking account. I really want the money and property that goes into the trust to be something that my clients can forget about. That's why I always want them to hold out plenty of money from the trust so that they don't have to play any games with the trust when they need money to buy a car, go on a vacation, remodel their kitchen, or whatever. In other words, I want my clients to have plenty of "jingle in their jeans." I never want my clients to feel "poor" after building and filling their irrevocable trust.

Mary: Looking at our list of assets and what we would hold out from the trust, I think we're in pretty good shape, don't you?

Richard: I think you're in great shape. You truly have an ideal arrangement for the use of this type of trust. Unfortunately, some of my clients who really want to use this strategy aren't a good fit because they have way too many dollars in IRAs, 401(k)s, or other tax-deferred retirement accounts. As a general rule, I don't want my clients to have more than about 40% of their total net worth in tax-deferred retirement plans. More than that and they simply won't get the bang for the buck they deserve when they pay for this type of planning. There are always exceptions to this rule, but it's one I stick to fairly closely. For example, I had some folks come in the other day who had a $900,000 estate. Their home was worth $250,000, they had $50,000 in a savings account, and they had $600,000 in two IRAs between them. Since we didn't want to withdraw the money from the IRAs and pay the taxes early, there really wasn't much we could do with these retirement plans. Sure, we could have put only the $250,000 house into the trust, but the likelihood of ever really needing that trust to save that house, given the big chunk of money in the IRAs, was low. Instead, I strongly recommended that my client's consider purchasing a long-term-care or life insurance policy using some of the IRA money. There are actually some very attractive single-pay long-term-care insurance policies out there on the market that lend themselves very well to payment through tax-deferred retirement accounts. Even life insurance is an attractive alternative when it's purchased through tax-deferred retirement account dollars. I frequently refer clients to long-term care insurance experts when I run into cases that just aren't a good fit for using the Lifetime Bulletproof Trust™.

John: We've got a number of health problems, so on top of not wanting to spend the money for insurance of any kind, we probably wouldn't be able to pass a physical to get it in any event.

Richard: I think we've discussed the main issues concerning the Lifetime Bulletproof Trust™. Even though creating an irrevocable trust may be intimidating to the uninformed, understanding the value of the two all-important powers built into the trust – the **"hammer,"** and the right to **"remove and replace"** your trustee – makes it a much friendlier proposition. Then, when you understand how the "back door," the "use and occupancy agreement," and the "trust protector" all work, there's little, if anything, to worry about!

Mary: Those powers really are comforting – especially the power to change beneficiaries, or, as you call it, the "hammer.".

John: I have to admit that this all sounds great; however, I have a bunch of questions about taxes and other details. For example, will this trust protect us from lawsuits?

Richard: Yes, and right away! There's no five-year wait necessary for lawsuit protection. However, I really don't think you have much to worry about when it comes to lawsuits. Just make sure you keep all of your insurance in place, and buy an "umbrella" liability policy to cover any extraordinary risks, if you haven't done so already.

John: I'm with you on this. I've had an umbrella policy for years.

Mary: Your explanation has really opened my eyes and given me a full appreciation of what we need to do to take control here. I am much more confident about moving forward. What about you, John?

John: Same here. I think we should go forward.