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By Aleksandra Todorova
Ask Smart Money

Tough Choices

Question: I am 79 years old, with three sons. All three attended prep school and finished college. They have done well, but the third one has very little. He quit his job and moved in to take care of me. How can I divide my estate fairly? My old will leaves equal shares to the three boys. I also fear my going in a nursing home could deplete my small estate and then my third son would have big problems. Please help. I lie awake at night, trying to solve these problems.

-----*Anonymous*

Answer: Many parents face these two common estate-planning predicaments: How to divide a limited estate fairly and how to make sure there *is* an estate to distribute, should pricey nursing-home costs come into play.

While we can't offer specific solutions to these problems-- the first issue is best discussed within the family, and the second with a qualified elder law attorney-- we can offer general advice. Keep in mind that estate planning regulations are complicated and state-specific. Also before you do anything, it's important to talk with an elder law attorney in your state. (If you don't already have one, you can find one at Elderlawanswers.com.)

Your first problem is ethical: Is it fair to leave more money to one son than to the others? While there's no right or wrong answer here, ethicist Bruce Weinstein, author of the upcoming book "Life Principles: Feeling Good by Doing Good" (Emmis Books, 2005) says that leaving more to a child who has sacrificed to care for a parent is by all means morally acceptable. That child not only needs more financial assistance, but he actually deserves more because by moving in to care for you he is doing something for you that the others aren't, says Weinstein. Assuming there aren't any factors complicating the situation-- say, the son has no assets of his own because of a gambling addiction or the other sons live nearby and provide equal care for their parent-- it would actually be unjust to give each of them an equal inheritance, says Weinstein. "It's unfair to give all kids in a class an A if one makes more effort than the others," he says.

Whatever a parent's decision in this scenario, it's important that he or she share it with all of the children. "If you talk to them in advance and explain to them 'this is what I'm doing and this is why I'm doing it,' they're much more likely to accept it," says Bernard Krooks, a partner at Littman Krooks in New York and president of the National Academy of Elder Law Attorneys. If there's a chance that any of the heirs might contest the will, Krooks suggests including a "no contest" clause, which typically specifies that whoever contests the will forfeits their share of the inheritance.

Now, let's move on to the other problem--namely, how someone with a limited estate can best preserve it for his or her heirs. At an average cost of \$70,080 annually, according to the latest MetLife Market Survey of Nursing Home and Home Care Costs, Nursing - home costs can easily demolish a modest estate plan. And while Medicaid will cover the tab once you've depleted your assets (in most states, single individuals should have \$2,000 or less in assets, excluding the value of their home, in order to qualify), that's small comfort for someone who has saved carefully in the hopes of leaving something behind for his or her kids.

If you think you might ultimately wind up on Medicaid, it might be tempting to start giving away assets now-- before potential nursing-home costs come into play. In certain circumstances this can be done, but it takes careful planning. Unfortunately, Medicaid has a 36- month look-back period for gifts, meaning that any gifts made out of one's estate in the 36 months prior to applying for Medicaid will disqualify him or her for eligibility for a certain period of time, based on the amount of the gifts.

The good news: Thanks to some common--and perfectly legal--maneuvers known as Medicaid Planning, you can preserve some of your assets and still qualify for Medicaid. One of them is an exception to the 36-month look-back period, known as the Caretaker Child Exemption. It allows a parent to deed his or her house to a child who has lived and taken care of them for at least two years before they enter a nursing home, regardless of the 36-month look-back period for asset transfers, explains Alexander Bove, a trust and estate attorney in Boston and author of "The Medicaid Planning Handbook." (If the house remains under the parent's name, on the other hand, the state will force a sale of the house after his or her death in order to recover the benefits distributed under the Medicaid program.)

One drawback to this strategy is that if the transfer takes place while the parent is still alive, the child will forfeit some tax benefits, says Krooks. When a house is inherited, a child can sell it with little or no capital gains because the cost basis for the house is stepped up to its market value on the date of the parent's death, he explains. If parents deed a house within their lifetime, on the other hand, the child will owe taxes on the difference between the sale price and what the parent originally paid for it. The solution: The parent can transfer the house and reserve a "life estate" for themselves, which basically means they will keep the right to live in the house for the rest of their life, Krooks says. This way, the child can sell the house after the parent's death using its current market value as its cost basis.

What can be done to preserve other assets? One option is the so-called "half-a-loaf" gifting technique, which allows individuals to transfer approximately half of their assets and use the other half to private-pay their nursing-home costs during the disqualification period. (For more details on this strategy, read our previous Ask on Medicaid planning.)

Another option is signing a "caregiver agreement" with the child who lives with the parent, suggests Krooks. The document should put in writing everything he or she does for Mom or Dad --- grocery shopping, visits to the doctor, taking the parent for walks and

so on. IN exchange for the child's services," the parent can legally pay him or her a salary. "As long as it's in writing, that would not be considered a prohibited transfer of assets for Medicaid purposes," Krooks says. The salary should be comparable to the average home health-care reate in the area, or else the state's Medicaid office may get suspicious. The catch: This will be taxable income to the child, and the parent might also need to pay Social Security and Medicare taxes (together referred to as FICA) as an employer.

Krooks' advice: speak with an elder law attorney to figure out which Medicaid planning method---the half-a-loaf, caregiver agreement, or any other alternative--makes most financial, and emotional, sense.