

# Western Mass Estate Planning

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112A State Street  
Shelburne Falls, MA 01370  
Telephone: (413) 625-2482  
Facsimile: (413) 826-7700  
[www.westernmassep.com](http://www.westernmassep.com)

*Deirdre Gleason, Esq., Owner  
Emily Arsenault, Legal Assistant  
Erin Fish, Office Manager  
Kathy Wagner, MassHealth Specialist*

## **RISKS AND RAMIFICATIONS OF LIFETIME GIFTS**

I am often asked by clients about the benefits of gifting assets to their children, charitable organizations, or other individuals. It is usually motivated by a desire to help someone who has financial hardships, to reduce a taxable estate (estates worth \$1 million or more are subject to Massachusetts estate taxes), and/or to preserve assets from feared long-term care expenses. Here are my thoughts:

- ❖ **Any transfer of \$1,000 or greater must be disclosed on a MassHealth application**, if the individual who made the gift needs in-home or long-term (nursing home) care and applies for MassHealth benefits within five (5) years of the transfer. MassHealth defines a “transferred resource (gift)” as *any transfer of any asset* (cash, real estate, cars, stock, etc.) for which equal value is not given in exchange. Selling a car for fair market value is fine, but giving the car to someone for free is not. It does not matter that the transfer was to help a child with legal fees in a divorce, to help a grandchild with college expenses, to pay someone’s medical bills, or a contribution to a worthy charitable organization. It is irrelevant that, at the time you made the gift, you were healthy and never dreamed you would need a care in the next five (5) years.

In all of these cases, you can expect MassHealth to impose a disqualification period, so that someone who is otherwise eligible (meets all other requirements, including having reduced assets to under \$2,000), will, instead, be denied benefits for a period of time based upon the amount of the total transferred resources (currently, each \$367 gifted results in one day of ineligibility). MassHealth assumes that every check you write as a gift for \$1,000 or greater was done with the intention of keeping the funds from a nursing home. I have had a few cases where I was able to convince MassHealth that the payments were not, in fact, for that purpose, but it is not easy to do. I have met with many distraught family members who desperately needed assistance to pay for nursing home care for a parent or spouse, but were faced with the fact that the family member had recently transferred funds, so was not eligible for assistance – often, for several years.

- I once met with the daughter of a woman who had just been admitted to a nursing home. We calculated that her mother has sufficient assets to cover approximately one year of care, at which time the family hoped she would qualify for MassHealth. The problem? The mother had given gifts over the past two years to her children and grandchildren, totaling \$35,000. The result?

When the mother exhausts the assets remaining in her name and the family applies for MassHealth, the mother will be denied benefits – for 96 days ( $\$35,000/\$367 = 96$ )!

- It can be remarkably easy to qualify for MassHealth benefits, so usually does not make sense to take any step which will threaten eligibility.
- Of course, if you are confident that you will never need a nursing home, have sufficient long-term-care insurance, or plan to self-pay, then this would not be a concern for you
- The federal gift exclusion of \$15,000/year/person (2019) is a separate concept and has no bearing on MassHealth eligibility

- ❖ **For tax purposes, a gift is any transaction in which an interest in property is gratuitously passed** or conferred upon another, regardless of the means or device employed. A gift is completed for tax purposes when the donor has irrevocably parted with dominion and control over all or part of the transferred property, leaving the donor without the power to change its disposition.
- ❖ **If you give appreciated assets to someone during your life, the recipient takes the asset with your cost basis** (what you paid for it originally or its value when you inherited it). When the recipient sells the asset, he or she has to pay tax on the profit made since the time you purchased/inherited the asset. So, if the stock you purchased for \$10/share grew to be worth \$100/share, and you gave it to someone who sold it immediately, that person would have to pay capital gains tax on the \$90/share increase in value. If you had 100 shares of that stock (it has grown from \$1,000 to \$10,000), Massachusetts residents could owe as much as approximately \$1,827 (20.3%) in capital gains taxes at sale.

Compare the above with keeping the asset and waiting for it to pass through your estate (Will or trust) to your heirs at your death. Assets remaining in your name at your death get a stepped-up basis for capital gains purposes. This means that the beneficiaries of your estate get a clean slate and do not have to pay any capital gains tax on the increased value of real estate, stocks, etc. which accrued up to your date of death. Yes, the asset is included in the value of your estate for estate tax purposes, but the estate tax rate is typically far lower than the capital gains tax rate. Massachusetts does not have a flat rate for estate taxes, but many people's effective estate tax rate falls in the range of 5-7%. Including the same shares of stock, which are now worth \$10,000, in the value of someone's taxable estate would result in an estate tax of approximately \$600, far lower than the capital gains tax would be if gifted during life.

- Note that charitable organizations do not pay capital gains taxes, so you may make gifts to charities at any time without considering tax ramifications (assuming you are aware of the impact on eligibility for MassHealth benefits, as discussed above)
- ❖ **Individuals with estates only slightly over \$1 million might discover that lifetime giving, despite the capital gains tax incurred by the recipient, saves**

**more in estate taxes.** If an estate is worth just a few dollars over \$1 million, the entire estate is subject to a Massachusetts estate tax of approximately \$37,000. However, if an estate is worth a few dollars under \$1 million, there is no estate tax. So, using the same example above with the appreciated stock, if that individual gifted the \$10,000 in stock just before death, reducing the value of the estate under \$1 million, the capital gains tax paid by the recipient of the \$10,000 (\$1,827) would be minimal, in comparison with saving \$38,000 in estate taxes, which would have been due on the entire estate, if the shares of stock had not been removed from its value.

- Note that any gifts to charitable organizations made in your Will or Trust reduce the value of your taxable estate (only gifts to individuals are subject to estate tax), but if the gross estate (before the gifts) was greater than \$1 million, Massachusetts will impose an estate tax on the balance, even if it falls under \$1 million.
- ❖ **The federal annual gift exclusion of \$15,000-per-person-per-calendar year is relevant only if an individual makes lifetime gifts of more than \$11.4 million (through 2025, then reverting to \$5 million in 2026) over the \$15,000 limit to one individual in any calendar year. No federal gift tax is due until that limit is met.**
  - In other words, individuals whose estates are worth less than \$11.4 million (and couples worth less than \$22.8 million) need not be concerned about limiting gifts to \$15,000. Gifts exceeding this sum must be reported to the IRS on a form 709, but no tax is imposed until the excess exceeds \$11.4/\$22.8 million.
  - Massachusetts has no gift tax; gifts exceeding \$15,000 need not be reported when made. The gifts are considered after your death, however, but only to determine whether those gifted amounts, when added to the assets remaining in your name, bring the value of your estate over \$1 million. If so, there will be a Massachusetts estate tax – but only on the remaining sum, not the sum gifted. This can be an effective way to significantly reduce estate taxes
  - MassHealth and capital gains tax consequences still must be thoroughly considered before aggressively making gifts.
- ❖ **Do not count on the recipient of any gift to keep the funds safe in case you need them back** (divorce, job layoffs, medical bills, college expenses, can jeopardize the funds)
  - I had a client who gave \$80,000 to his son to safeguard and his son, instead, used the money for his failing business.
  - In another case, the son lost half of the transferred funds in his divorce proceedings.
  - In yet another case, a father conveyed his house to his son, with the son's promise that his father could live in the house for the rest of his life. Guess who made life miserable for his father, hoping he would move out?
  - If the recipient may be applying for financial aid for themselves or a child, the gifted funds will be considered when determining eligibility.

❖ **Do not count on the recipient of any gift to share with your other children/family members/intended beneficiaries of your estate.** Again, various circumstances can jeopardize the funds (see above).

➤ I had a client transfer her home to her son, with his sincere promise that he would sell it upon her death and distribute the proceeds equally among himself and his three brothers. He truly intended to do so, but, at the age of 58, shortly after his mother's death, he had a heart attack and entered a nursing home. If he kept the house, he would be eligible for MassHealth to pay for most of his care; if he gifted the house or the proceeds from its sale, he would disqualify himself for many months. Sadly, this is a promise that will likely never be fulfilled.

❖ Of course, **if you have a family member or other individual/organization in dire need of financial assistance** and are confident that:

- 1) you will not need a nursing home for at least five (5) years from the time you make the gift (so the transfer would not impact eligibility for MassHealth benefits);
- 2) if you do need nursing home care within five (5) years, you have sufficient resources to pay privately (you do not plan to apply for MassHealth), for the balance of the five (5) years; and/or
- 3) you do not mind that the recipient may pay more in capital gains taxes than if you had waited for the person to inherit those funds at your death.

**Then you may elect to gift any assets you wish.** At least you will do so, knowing the risks and ramifications.

*This is intended to be a general discussion about MassHealth and estate, income, and capital gains tax considerations when evaluating the benefits and risks of transferring assets worth \$1,000 or greater and was current as of January 20, 2019. Individual circumstances may impact options and outcomes. Because each situation is different and the laws relating to MassHealth eligibility are regularly changing, a competent elder law attorney and/or qualified Certified Public Accountant should be consulted concerning any particular situation and legal advice relative to these issues. This article is for informational purposes only and is not intended to constitute comprehensive or specific legal advice.*