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## **Irrevocable Income Only Trusts**

Due to the high costs associated with long-term care, it is critical for many individuals to qualify for Medicaid assistance. The major concern for most individuals who anticipate future long-term care expenses is how to qualify for Medicaid to help pay for nursing home care. While there are various planning strategies used to qualify for Medicaid long-term care assistance, transferring assets into an Irrevocable Income Only Trust (“IIOT”, “trust”) is becoming increasingly popular. The purposes of the IIOT are (1) to provide a source of income, (2) to protect and manage assets, (3) to obtain Medicaid eligibility, and (4) to avoid the costs and time associated with probate.

IIOTs allow individuals to transfer their assets into a trust as protection in lieu of making outright transfers to their children. Under the terms of an IIOT, the person establishing the trust (“grantor”) will receive all of the income produced by the assets in the trust for the grantor’s lifetime. By transferring assets into an IIOT, the grantor will still reserve some control and retain some interest in the transferred assets – advantages that are not available when assets are given outright to individuals. If the grantor places the grantor’s home into the trust, then the trust agreement can specifically provide for the grantor to continue to reside in the home for the grantor’s lifetime. Because IIOTs are irrevocable, the grantor cannot revoke the trust and reacquire the assets; therefore, the assets are not available for Medicaid eligibility purposes.

IIOTs are commonly used to permit Medicaid to pay for the high cost of long-term care, once the Medicaid look-back period has passed. The look-back period is currently set at five years. The look-back rule means that Medicaid will penalize an applicant who gives assets to others (including a trust) within five years prior to filing a Medicaid application. Assets transferred into a trust more than five years prior to the filing of a Medicaid application will not impact Medicaid eligibility. If a penalty is imposed because of a transfer to an individual or a trust within five years of a Medicaid application, the period of ineligibility is based on the total of the gifts during the look-back period and begins when the individual enters a nursing home and is otherwise eligible for Medicaid.

IIOTs also offer tax advantages. The grantor is treated as the owner of the trust for income tax purposes. This is valuable because the trust’s income tax rates are usually higher than the grantor’s income tax rates. Additionally, the IIOT can be drafted to include a special power of appointment for the limited purpose of including the trust assets in the grantor’s “estate” for estate tax purposes. A special power of appointment will also permit a grantor to change the beneficiaries who will receive the assets upon the grantor’s death. Upon the grantor’s death, the trust assets obtain a “step-up” in value.

This means that when the assets are distributed to the grantor's chosen beneficiaries, the beneficiaries' basis in the assets for income tax purposes will be the value of the assets as of the grantor's date of death. As a result, the beneficiaries will avoid any capital gains taxes on the appreciation of the trust assets between the date of acquisition and the grantor's death if the property is sold after the grantor's death.

Irrevocable Income Only Trusts can be valuable planning tools in planning for Medicaid for long-term care and for protection of assets that are intended to be passed on to children or others without necessity of probate. Contact us at 866-ELDERLAW for information and assistance with such planning.