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Estate Planning vs. College Financial Aid

In the world of college financial aid, good estate planning strategies often result in less financial aid for your child or grandchild. For instance, a strategy included in many estate plans involves making annual tax-free gifts to children for education expenses. In 2009, any person can make an annual gift up to a maximum of $13,000, or $26,000 if the gift is split with your spouse, to any number of individuals with no gift tax consequences (up from $12,000 and $24,000 respectively in 2008). Once the gift is made, the assets are removed from your taxable estate and any income on the gift is taxable to the recipient.

While gifting is a good strategy for tax planning, a problem may result from how assets are treated when applying for college financial aid. To determine a student's financial aid amount, a college takes the cost of attending that school and subtracts your expected family contribution (EFC).

When calculating the EFC, the college generally considers the parents' income and assets, as well as the child's income and assets. Currently, a maximum of 5.6 percent (5.6%) of the parents' assets and up to 47 percent (47%) of the parents' income is included in the EFC, while 20 percent (20%) of the child's assets and up to 50 percent (50%) of the child's income is included.

The difference between 20 percent (20%) of the child's assets and 5.6 percent (5.6%) of the parents' assets can make a big difference in a financial aid award. For example, suppose you have been making $10,000 gifts to your child for the past ten years, and your child now has a total of $100,000 of assets. For financial aid purposes, your child will be expected to use $20,000 (20%) of those assets towards first-year college expenses. On the other hand, if you still owned the $100,000 in assets, you would only be expected to use a maximum of $5,600 (5.6%) toward first-year college costs. This means if you had *not* been making annual gifts, your child would be much more likely to receive financial aid. If a grandparent makes the gift, the grandparent's assets are not considered in the calculation of the EFC; however, the grandchild's assets would still be considered.

So, before starting an annual gifting program, consider the possible impact on financial aid calculations. Become familiar with financial aid formulas, roughly calculating what the student could expect in terms of financial aid. You should consider which college your child or grandchild is likely to attend. Currently, nearly 30 elite colleges only consider about 5 percent (5%) of both the parents' and student's assets in financial aid calculations (called the "Consensus Approach"). While the federal financial aid formula and other

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Pension Reform Bill of 2006

Pension Reform Bill of 2006 allows conversion of life insurance policy to Long Term Care policy.

Today only a fraction of people who need to pay for extended care actually buy any long term care (LTC) insurance, according to the AARP. But thanks in part to the Pension Protection Act, new pension law which was passed in 2006, and will go into effect January, 2010, persons who have built up equity in a life insurance or annuity policy and feel they don't need it anymore (since their children are grown and fending for themselves, for instance), will soon be able to trade in their existing policies for LTC insurance. This trade-in will eliminate taxes they'd otherwise have to pay to realize the cash benefits of their life and annuity programs.

One of the provisions of the Pension Protection Act permits you to exchange a life insurance or an annuity policy for a single-premium long term care policy on a tax-free basis, according to Michael E. Kitces, author of the book The Annuity Advisor. Mr. Kitces cites the following as a common client refrain: "'There's a policy I've been paying on for 25 years while I've raised my family. Now, the kids are out of the house, my spouse is working, and if I go after my cash value, the proceeds are taxed as regular income.'" Since the passing of the Pension Protection Act, Mr. Kitces notes that "Now, that individual can use the cash value he or she has accumulated to purchase LTC coverage and it's "a tax-free exchange."

Insurers are still in the process of shaping their LTC strategies in response to the new pension law. "This is what's coming down the pike," says Mr. Kitces. He expects insurance companies to begin marketing the programs within the next several months.

Estranged Father Receives Estate

Estranged father receives estate of son whom he had not seen for 42 years. (California)

One hundred years ago the California Supreme Court warned that ". . . succession to estates is purely a matter of statutory regulation, which cannot be changed by the courts," and that ". . . it is vain to argue against the injustice of the rule . . ." This rule of law, that is, strict adherence to the laws of intestate succession, has not changed. In a recent decision, the California Court of Appeals followed the law as declared by the California Supreme Court.

We may feel that this particular rule of law regarding inheritance rights is unwise or that the result of the application of the rule is unfair. However, if this family situation occurred in Missouri, the outcome would be the same. The California court's recent opinion shares its view of the situation, stating, "It is unfair that father should reap a financial windfall after the death of his son. This is so because father never even saw his son for the 42 years he lived. We hold that a probate court may not, on principles of equity, disinherit a natural parent who abandons a child who later dies intestate." Estate of Shellenbarger, 2008 Cal. App. LEXIS 2468 (December 29, 2008)

DO YOU HAVE A WILL?

Estate Planning vs. College Financial Aid

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colleges have not yet followed, the calculations may change in the future.

If, after going through the calculations, you find the student probably won't be eligible for financial aid, you may decide to make annual gifts to the child. However, if the calculation indicates the student may receive financial aid, you might want to hold off on an annual gifting program.

Assuming it does make financial sense to make annual gifts to a child or grandchild, consider establishing a 529 college savings plan. Such a plan allows anyone, including parents or grandparents, to establish and contribute to a special educational fund for the child. Missouri offers a 529 college savings plan, known as MOST. This plan has a number of tax benefits, including the following:

- **Federal income tax benefits**. Your assets grow tax-deferred, and withdrawals are exempt from federal income tax when used for qualified higher education expenses.

- **Additional advantages for Missouri taxpayers**. Account Owners may deduct up to $8,000 in the aggregate for contributions to all accounts of the Account Owner in any taxable year. Only the Account Owner may claim a deduction for contributions to an Account. A husband and wife filing jointly may deduct up to $16,000 in the aggregate, even if only one spouse has income.

Federal gift tax incentive. You can choose a special election that allows you to treat a single $65,000 contribution ($130,000 for married couples filling jointly) as if it were made over a five-year period. (Gifts in excess of these amounts may be subject to federal gift tax).

For more information about this incentive, consult a qualified tax advisor, or visit the MOST website:

https://missourimost.s.upromise.com

New Report Examines Tax Treatment of Senior's Income

The latest installment of the Public Policy & Aging Report (PPAR), published quarterly by the National Academy on an Aging Society, examines wide-ranging tax provisions that affect older taxpayers. The provisions examined include deductions, exemptions, deferrals, and circuit breakers, most of which benefit older adults. This subject matter has particular relevance as President Obama prepares a plan that may eliminate income tax for persons aged 65 and older who earn less than $50,000.

"In the present environment, where federal, state, and local governments' budgets are under enormous stress, the tax treatment of older people is clearly worth a careful review," said PPAR editor Robert Hudson, PhD. The new PPAR report, authored by economists and AARP Policy institute scholars John Gist, PhD, and David Baer, devotes four articles to addressing the twin questions of how tax codes differentially affect older people as opposed to the remaining population and whether such treatment is consistent with the original intent of these provisions.

Currently, over half of states exempt Social Security income from taxes, half exempt some or all private pension income, and two-thirds exempt some or all government pension income. For nearly 50 years, the federal government never taxed Social Security income. Currently, many middle-income and all high-income seniors have that income taxed, up to 85% of their Social Security income.

SOUTH COUNTY SENIOR LAW & ESTATE PLANNING CENTER, LLC

5520 Telegraph Rd., Suite 104
5518 Telegraph Rd., Suite 102
St. Louis, MO 63129

Phone: 314-845-0541
Fax: 314-845-2580
Email: dmertz@STLseniorlaw.com
mkennedy@STLseniorlaw.com
chart@STLseniorlaw.com

Dennis B. Mertz

Mavis Kennedy (seated)

Christine F. Hart

South County Senior Law & Estate Planning Center, LLC has been serving the needs of our senior clients for twenty years. The firm attorneys, Dennis B. Mertz, Mavis Kennedy, and Christine F. Hart are members of NAELA, Inc. (National Academy of Elder Law Attorneys), dedicated to meeting the legal needs of all persons of all ages, including seniors.

We concentrate our practices in the areas of estate planning, trusts and estates, powers of attorney, probate, asset preservation, including Medicaid planning and tax advice, Special Needs Trusts and trust administration, nursing home abuse, will contests and other contested estate matters, financial exploitation of the elderly, personal injury, and guardianships and conservatorships. The initial consultation with any of our senior law attorneys is always at no charge or obligation to employ our firm. Call us at (314) 845-0541 to schedule an appointment to discuss any of your legal questions.

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Anyone wishing to be added to our newsletter mailing list should contact our office at (314) 845-0541 with your request.

Missouri Appellate Court Permits Recovery of Medicaid Benefits Against Life Estate

The Eastern District Missouri Court of Appeals recently held in *Estate of Leonilda Hayden, et. al.*, No. ED90403 (Mo. App E.D. 2008), that the Missouri Department of Social Services could recover the cost of Medicaid benefits provided a decedent against a life estate with power of sale which the decedent held at death.

In 1979, Leonilda Hayden transferred her home to her children, retaining a life estate with the power to sell, mortgage, or lease the property during her lifetime. She died in 2005, after receiving over $95,000 in Medicaid benefits.

The family argued that the 1979 deed was not a recoverable non-probate transfer or, in the alternative, that the State could not recover more than the nominal value of the life estate.

In finding that the State could recover against the entire value of the home for Medicaid benefits Mrs. Hayden received during her lifetime, the Court pointed out that Hayden had retained the power to sell or otherwise transfer the property during her lifetime, rendering the deed (in the Court's eyes) revocable by the decedent.

The Court stated, "The fact that DSS is able to reach the full value of the property is . . . the natural consequence of Decedent's self conveyance of a power to revoke."

The case does not address whether the State could recover Medicaid benefits against a life estate that does not include a power to sell. However, the opinion indicates that in such an instance, recovery may be limited to the value of the life estate, which may be minimal.