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included in the taxable estate at death."

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In March, the IRS issued Revenue Ruling 2023-2, which had a substantial impact on estate planning, particularly where an irrevocable trust is involved. In the last decade or so, more families have begun utilizing irrevocable trusts to protect their assets from spend-down in order to qualify for government benefits, such as Medicaid and VA Aid and Attendance.

Prior to the issuance of this ruling, it was unclear whether assets passing to

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recipients a step-up in basis, so they inherit the asset as if it had been purchased at the *current* fair market value, not the value at the time the asset was actually purchased. This eliminates any capital gains, and so no taxes become due.

What about an irrevocable trust?

But what to do about assets in an irrevocable trust? They are not currently held by the purchaser of the asset, nor have they passed to the beneficiaries. Prior to March 2023, such transfers from the trust at death have been generally receiving the step-up in basis. But that may not be the case any longer. This new ruling by the IRS states that property held in an irrevocable trust *that is not included in the taxable estate at death* will not receive a step-up in basis any longer.

At first glance, it sounds like anyone who does irrevocable trust planning will be subjecting their children to additional taxes. You may be wondering why anyone would do irrevocable trust planning in the first place. As Americans are aging and living longer, more are finding themselves in need of long-term care to the tune of, on average, $6,500 to $10,000 per month, depending on where you live and what level of care you need.

Very few families can afford to pay that out of pocket without depleting their life savings, which means turning to programs like Medicaid or VA Aid and Attendance to help with the cost. However, before you can qualify for such programs, you will be expected to go through a spend-down of your assets to a level set by the state in which you reside. One of the only tools that can protect assets from being subject to the spend-down process is an irrevocable trust.

Does asset protection planning now mean that to avoid the spend-down, you will have to subject your children to additional taxes? Maybe. The key part of the IRS's decision is that only those assets that are held in an irrevocable trust that are not

otherwise included in your estate at death for estate tax purposes will lose the step-

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most families, even with the inclusion of the value of their home, will not have estates large enough to be subject to estate taxes. Thus, your assets can be protected from spend-down due to long-term care, avoiding capital gains taxes and estate taxes and passing to your children tax-free. It just takes very careful planning.

By way of example, let's look at a couple whom we will call Tom and Jane. Tom and Jane purchased a home in 1975 for $100,000. If that house is now worth $250,000 and they sell that house, they will owe capital gains taxes on the growth of $150,000. In contrast, had Tom and Jane transferred their home to an irrevocable trust, prior to March 2023, the trust could sell the house from a cost basis of $250,000, not $100,000 (because of the step-up in basis), so no capital gains would be due when the trust then distributes those proceeds to Tom and Jane's children. Post-Revenue Ruling 2023-2, unless the trust is properly worded to ensure that the $250,000 value of the home is included in Tom and Jane's taxable estate, the children will owe capital gains on $150,000.

Most families will not find themselves subject to estate tax when the value of their home is included because the current federal estate tax is only applicable to estates valued at $12.92 million or more. It will be more likely to impact families when the estate tax limit is lowered in 2026 to about half of that exemption amount. (For more about this, see the article These Tax Cuts and Jobs Act Provisions May Sunset Soon.)

If you currently have an irrevocable trust or are interested in learning more about one, seek legal counsel from an attorney who is knowledgeable in both elder law and estate planning. It is also always a good idea to get your tax professional involved in the conversation so that nothing is missed in your plan.

The world is becoming more complex, as are the tax laws, but you (and your children) can still come out ahead with sound advice and planning.

ABOUT THE AUTHOR

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