

**MEDICAID PLANNING
FOR MARRIED COUPLES**

by

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I. CASE STUDY

Bill and Hattie have been married for 62 years. Bill has been diagnosed with Alzheimer’s disease and expects to enter a nursing home in the near future. The couple’s assets are as follows:

\$200,000	Residence
\$ 50,000	Bank Account
\$ 30,000	Securities
\$ 10,000	Hattie’s IRA

In addition, Bill has life insurance with a cash value of \$10,000. Hattie has a term insurance policy for \$10,000 naming Bill as beneficiary. Bill and Hattie have a mortgage on their home with an unpaid balance of \$10,000. Their real estate taxes are \$2,000 per year. They recently received their tax bill and paid the August 1 quarter, but have not paid the quarters for November, February or May. Hattie indicates that their washer and dryer are on their last legs and that their roof needs replacement. When Bill enters a nursing home Hattie intends to move in with her son, Brian, and sell the family residence. Bill and Hattie have burial plots, but do not have prepaid funerals. Hattie’s car is 14 years old and has 180,000 miles. They have asked their daughter, Jennie, to move in with them and to help Hattie care for Bill in the hopes of keeping him home from a nursing home longer. Hattie inquires of you whether it would make sense for her to divorce Bill. Hattie’s IRA names Bill as beneficiary.

Bill has monthly income of \$800 from Social Security and \$200 from a pension for a total of \$1,000. Hattie’s income consists entirely of Social Security income in the amount of \$400.

II. TECHNIQUES AND STRATEGIES

In situations involving a Community Spouse there are a number of basic Medicaid planning techniques as well as some cutting edge strategies to be considered. An outline follows:

a. Spending Down

1. Prepay Real Estate Taxes

In situations where the home is occupied by a community spouse it makes sense to prepay real estate taxes. Since the home is occupied by the community spouse it is a non-countable resource. Expenditure of the funds for payment of the real estate taxes constitutes valid spend down.

Let's suppose real estate taxes are paid quarterly on February 1, May 1, August 1 and November 1 in the amount of \$500 per quarter. If a married couple needs to do a spend down in March, they could prepay the real estate taxes for the rest of the calendar year.

2. Pay Off Debts

Frequently the family of the Medicaid recipient has outstanding debt, such as a home mortgage, home equity loan, car loans or credit card debt. Once the snapshot is taken all of these debts can be paid from the share of the institutionalized spouse.

3. Payment of Services

Payment of services such as medical bills and legal fees can be paid out of the assets of the institutionalized spouse once the snapshot has been taken.

b. Convert Countable Assets to Non-Countable Assets

1. Buy Household Goods or Personal Goods

Personal effects and household goods are excluded to the extent that the total equity value of such resources does not exceed \$2,000. In practice, Medicaid does not appear to enforce the \$2,000 limit.

2. Make Home Improvements

Making home improvements is a way to convert countable assets (i.e., cash and securities) into a non-countable asset (i.e., a personal residence). A home and lot used as a principal residence are excludable resources. Therefore, funds expended to make home improvements are converted from countable to non-countable assets. It is not good strategy to spend money on home improvements just to spend money, but often the expenditure is worthwhile in terms of permitting the community spouse to reside more comfortably in the home and to prepare the home for eventual resale.

Example: A married couple has countable assets of \$100,000. After the Community Spouse Resource Allowance has been determined, \$50,000 must be spent down. Monies can be spent as follows:

	\$ 2,500	New Roof
+	\$ 2,000	New Heater
+	\$ 2,000	Interior Paint
+	\$ 3,500	Carpet
+	\$ 1,000	Aluminum Siding
+	<u>\$ 1,000</u>	Windows
	\$12,000	Total Home Improvements
	\$50,000	Spend Down
-	<u>\$12,000</u>	Home Improvements
	\$38,000	Remaining Spend Down

3. Purchase New Home

Occasionally, when one spouse enters a nursing home, the community spouse decides that the current home is too big and decides to move to a smaller home or even a condominium. If, after the beginning of the continuous period of institutionalization, the home is sold and the proceeds of sale from the original principal residence are reinvested into a more expensive home, then the additional funds spent on the new home are converted from a countable asset to a non-countable asset.

Example: A married couple lives in a \$100,000 residence. In addition, they have \$100,000 of countable assets. After determining the Community Spouse Resource Allowance, \$50,000 must be spent down. They can sell the \$100,000 principal residence and reinvest in a \$125,000 condominium. The calculation is as follows:

	\$50,000	Spend Down
-	<u>\$25,000</u>	Purchase of Principal Residence
	\$25,000	Remaining Spend Down

4. Purchase Life Estate From Children

HCFA Transmittal 64 §3258.9A discusses life estates. Life estate and remainder interest tables are furnished. The HCFA discussion centers on transfer of a remainder interest in a property with a retention of a life estate by an individual. The same logic, which permits such a transfer and details the method for evaluation of the life estate and retained interest, should permit purchase of a life estate by an individual.

It is likely that states will resist this technique if it is abusive. A conservative approach would be to use this technique only if an elderly parent is actually going to live in the house of the child for a period of

time prior to entering a nursing home, or if the community spouse will live in the home of a child.

Example: A married couple has countable assets of \$100,000, and the husband is entering a nursing home. After determining the Community Spouse Resource Allowance, \$50,000 must be spent down. Their son has a home worth \$100,000 with no encumbrance. The wife, who is 74 years old, is going to live with the son. Using HCFA Transmittal 64 section 3258.9A, the value of the life estate is \$52,149. The value of the life estate is calculated:

	\$100,000	Value of Home
x	.52149	Factor
	\$ 52,149	Value of Life Estate

5. Prepaid Funeral

Most states do not count funds in an irrevocable funeral trust as countable assets. Also, most states do not have a dollar limit on the amount that can be expended for the funeral. The monies must be put in an irrevocable trust; the trust must be for the benefit of the Medicaid applicant; and the trust must be established by an individual who reasonably anticipates applying for or receiving Medicaid benefits.

An alternative to an irrevocable funeral trust is an irrevocable assignment of a life insurance policy in exchange for funeral services of the same or greater value as the cash surrender value of the policy. Funeral directors require a paid-up policy.

Example: A client who needs to spend down \$50,000 uses \$6,000 for a funeral trust.

	\$50,000	Spend Down
-	\$ 6,000	Funeral
	\$44,000	Remaining Spend Down

6. Purchase New Car

Frequently, when one spouse enters a nursing home, the other spouse is driving an old car with high mileage. A good strategy is to have the community spouse purchase a new car as part of the spend down. Under current law the best time to purchase the car would be after the institutionalized spouse enters a nursing home. Under federal law, the first \$4,500 of the value of a car is excluded from the calculation of countable assets.¹ However, if the car is used for medical

¹42 U.S.C. §1382b.

transportation or transportation in connection with employment, the entire value of the car is noncountable.² Many states simply permit one car to be noncountable regardless of value or use.

Example: A client who needs to spend down \$50,000 purchases a \$20,000 new car.

	\$50,000	Spend Down
-	<u>\$20,000</u>	New Car
	\$30,000	Remaining Spend Down

c. Exempt Transfers

1. Transfer Home to Community Spouse

The residence can be transferred to the individual's spouse. Any transfer of any asset from one spouse to another is exempt for Medicaid transfer purposes. In a typical situation, husband and wife own the home together. If one spouse enters a nursing home, and the community spouse predeceases that spouse, then by operation of law title to the home will vest in the institutionalized spouse. The institutionalized spouse would then be required to sell the home and use the proceeds for nursing home care. The home should always be transferred to the community spouse to avoid Medicaid estate recovery. If the home is not transferred to the community spouse and the Medicaid recipient dies, the community spouse might consider selling the home or transferring the home in order to avoid estate recovery.

2. Transfer Non-Home Assets to Community Spouse

The transfer penalties do not apply to a transfer of assets to the community spouse. This is also an exempt transfer. The assets forming a part of the Community Spouse Resource Allowance (CSRA) must be transferred to the community spouse within 90 days of Medicaid eligibility; otherwise, they are no longer exempt as part of the CSRA.³

For example, a husband is ready to enter a nursing home. The husband transfers all of his assets to his wife. All assets in the names of the husband and wife are also transferred to the wife. This protects the assets as a part of the wife's CSRA. If the wife dies prematurely, her will leaves the assets to a special needs trust for the benefit of the husband, and on the death of the husband to their children.

²42 C.F.R. §416.1218.

³42 C.F.R. §416.1242.

3. Transfers to Disabled Children

Transfers from the institutionalized individual or the community spouse to the institutionalized individual's child, who is blind or permanently and totally disabled, are exempt.⁴ Therefore, there is no transfer penalty. For example, a potential Medicaid applicant is single and has \$100,000 of assets. He could transfer the \$100,000 to his blind daughter immediately prior to entering a nursing home. There would be no period of ineligibility due to the transfer.

d. Transfers For Value Not Subject to Penalty

1. Purchase Commercial Annuity

Purchase of an annuity by a community spouse is a viable planning opportunity in most, but not all, states. In a recent Pennsylvania case,⁵ the Pennsylvania Commonwealth Court held that the purchase by the community spouse of an annuity in the amount of \$365,000 immediately prior to applying for Medicaid for the institutionalized spouse would bring the community spouse's income far in excess of the Minimum Monthly Maintenance Needs Allowance (MMMNA) and would effectively shelter assets far in excess of the Community Spouse Resource Allowance (CSRA) and, therefore, constituted a transfer of assets subject to the Medicaid period of ineligibility.

In apparent reliance on this case, New Jersey enacted a Medicaid regulation to the effect that to the extent that the amount of the annuity combined with other assets forming a part of the Community Spouse Resource Allowance exceeded the maximum Community Spouse Resource Allowance the annuity was an available resource.⁶ However, several courts have held that the purchase of an annuity that complies with the provisions of HCFA Transmittal 64 is a valid Medicaid planning strategy. Ohio challenged the purchase of an annuity as a transfer, but the Ohio Court of Common Pleas held that the purchase of annuity by an institutionalized spouse to benefit the community spouse was not an improper transfer.⁷

In Delaware the Superior Court held⁸ and the Supreme Court later affirmed that the purchase of an annuity by a community spouse was not a transfer subject to the Medicaid transfer penalties and that the

⁴42 U.S.C. §1396p(c)(2)(B)(iii).

⁵Dempsey v. Department of Public Welfare, 756 A.2d 90.

⁶N.J.A.C. 10:71-4.10 (p) i.

⁷Perkins v. Ohio Dept. of Job and Family Services (Ct. Comm. Pleas, Mont. Cty., No. 2000-1485, April 16, 2001).

⁸Dean v. Delaware Department of Health and Social Services, 2000 W.L. 33201237.

annuity was an inaccessible resource since it could not be liquidated and, therefore, not considered a resource. Mr. Dean's property right in the annuity was income not a resource.

The Eastern District of Pennsylvania held that Medicare Catastrophic Coverage Act (MCCA) does not apply to the purchase of annuities as held by the Pennsylvania Commonwealth Court in the Dempsey case. The Mertz Court held that "the institutionalized spouse can transfer unlimited assets to the community spouse or to a third party for the sole benefit of the community spouse." The Court stated, "A couple may effectively convert countable resources into income of the community spouse which is not countable in determining Medicaid eligibility for the institutionalized spouse by purchasing an irrevocable, actuarially sound commercial annuity for the sole benefit of the community spouse. It is a loophole apparently discerned by lawyers and exploited by issuers who advertise such annuities as a means to qualify for Medicaid benefits. The definition of loophole, however, is an 'ambiguity, omission or exception that provides a way to avoid a rule without violating its literal requirements.'...It is for the Congress to determine if and how this loophole should be closed." Therefore, the Court held that the purchase of the annuity did not constitute a transfer of assets subject to a Medicaid period of ineligibility.

These Court decisions are consistent with interpretations of law by the Department of Health and Human Services (HCFA). In a letter to Ramon Harvey⁹ HCFA stated, "Transfers of assets by a spouse to a third party for the sole benefit of a spouse are not subject to penalty. The purchase of an annuity would constitute a transfer to a third party (the entity selling the annuity)." The letter goes on to explain that the annuity must be actuarially sound and under those circumstances would not be subject to a Medicaid period of ineligibility. In a subsequent letter to the Nevada State Welfare Division HCFA reiterated this position.¹⁰ The letter states, "The State's policy treats payments from an annuity that exceed the maximum spousal impoverishment income allowance as a transfer of assets for less than fair market value. We had previously and formally advised the State that in placing such a limit on the amount of income an annuity can generate for a community spouse, the State is effectively imposing a penalty on a transfer to a third party (in this case the annuity) for the benefit of the spouse which is in violation of section 1917(c)(2)(B) of the Social Security Act."

⁹Letter from Thomas E. Hamilton, Director, Disabled and Elderly Health Programs Group, Department of Health and Human Services, to Ramon B. Harvey, P.A., January 19, 2001.

¹⁰Letter from Linda Minagnote, Associate Regional Administrator, Division of Medicaid, Department of Health and Human Services to Nancy Angres, Administrator, Nevada State Welfare Division, dated August 31, 2001.

The letter from Mr. Hamilton to Mr. Harvey goes on to say that the designation of a beneficiary to receive any funds remaining in the annuity after the death of the primary beneficiary does not violate the requirement that the annuity be for the sole benefit of the primary beneficiary.

2. Annuity Trust “For the Sole Benefit Of”

i. Spousal annuity trust

In some states it is possible to establish a trust “for the sole benefit of” the community spouse. Since the transfer is for the sole benefit of the spouse, it is exempt from the transfer penalty. In a private letter HCFA has taken the position that a trust established for the sole benefit of a community spouse under HCFA Transmittal 64 is an available resource.¹¹

HCFA Transmittal 64 deals with transfers of assets and spousal impoverishment provisions.¹² It states that transfers for the sole benefit of a spouse and transfers from a spouse to a third party for the sole benefit of the spouse are exempt transfers. However, it also says that resources transferred to a community spouse are still considered available to the institutionalized spouse for eligibility purposes. This section goes on to say that “the exception for transfers to a third party for the sole benefit of the spouse may have greater impact on eligibility because resources may potentially be placed beyond the reach of either spouse and thus not be counted for eligibility purposes.”¹³

It is possible for the institutionalized individual or the spouse of the institutionalized individual to establish a trust for the sole benefit of the community spouse under which the assets placed in the trust would be paid out to the community spouse over the lifetime of the community spouse.¹⁴

ii. Disability annuity trust

Disability annuity trusts are subject to the same rules as spousal annuity trusts. Transfers to such trusts are exempt from the Medicaid transfer penalties. However, availability is an issue

¹¹ Letter dated April 16, 1998 from Robert A. Streimer, Disabled and Elderly Health Programs Group, Center for Medicaid and State Operations, Health Care Financing Administration to Jean Galloway Ball.

¹² HCFA Transmittal 64 §3258.11.

¹³ *Id.*

¹⁴ HCFA Transmittal 64 §§3257b6, 3258.11.

that must be addressed. Also, in considering the use of an annuity trust for a disabled person, care must be taken to examine the other government benefits currently being received, or which may in the future be received, by the person with disabilities.

If the person is receiving SSI, that person also receives Medicaid. SSI is a means-based program. Both resources and income are considered in determining eligibility. If the person with disabilities receives income from the annuity trust, this may well disqualify that person from receiving SSI and cause a loss of Medicaid.

If the person with disabilities is receiving SSD, this is accompanied by Medicare. SSD and Medicare are insurance-based programs, rather than means-based programs. Receipt of income from the annuity trust would *not* cause a loss of SSD or Medicare. However, consideration should be given to other benefits that the person with disabilities may receive in the future. For example, will the person with disabilities be a candidate for group housing in the future? If so, the existence of the annuity trust may cause them to lose that benefit.

Example: A married couple has \$200,000 in countable assets. Their daughter, who is legally blind and is receiving SSD, has a life expectancy of 20 years. If the parents transfer \$100,000 from a money market to a disability annuity trust for their daughter, she will receive all of the income and \$416.67 per month from principal over the next 240 months. The calculation is as follows:

	\$200,000	Countable Assets
-	<u>\$ 90,660</u>	CSRA to be Retained by Community Spouse
	\$109,340	Spend Down
-	<u>\$100,000</u>	Transfer to Disability Annuity Trust
	\$ 9,340	Additional Spend Down

iii. (d)(4)(A) trust

A (d)(4)(A) trust is a self-settled special needs trust established with the funds of the grantor. Those funds are usually obtained through a personal injury claim, an inheritance, or equitable distribution and/or alimony from a divorce.¹⁵ There is no

¹⁵ 42 U.S.C. §1396p(d)(4)(A).

transfer penalty for transferring assets into the trust. The assets in the trust are not considered “available” for Medicaid eligibility purposes, but there is a payback requirement that the trust repay Medicaid for any monies advanced on behalf of the trust beneficiary upon the death of the trust beneficiary.

There are six requirements for a (d)(4)(A) trust:

- Must be funded with assets of the individual
- Individual must be under 65 years of age
- Individual must be disabled
- Trust must be established by a parent, grandparent, legal guardian or a court
- Any state that paid medical assistance on behalf of the individual must be reimbursed upon death of the individual
- Reimbursement must be up to an amount equal to the total medical assistance paid on behalf of the individual

iv. Pooled trust

A pooled trust is authorized by OBRA '93.¹⁶ These trusts are funded with assets of a disabled person. They must be run by a non-profit and the funds are pooled for investment management purposes, but a separate account is maintained for each beneficiary. The account is solely for the benefit of the disabled individual. The disabled person can be over 65 at time of the establishment of a trust, but some states impose a penalty for transfers made after age 65. Transfers to a pooled trust by persons under age 65 are exempt from the Medicaid transfer penalties.

3. Private Annuity

It is possible for a parent to transfer assets to a child in exchange for a private annuity. Under the private annuity, the child would calculate to the actuarial life expectancy of the parent and make payments to the parent on an actuarially sound basis. Good practice would dictate that the same rules applying to a private annuity for estate tax planning purposes would apply in this situation. The Section 7520 Applicable Federal Rate should be used in calculating the payment. The annuity would work in much the same way as a commercial annuity, except that since the child already has the assets of the parent, there would be no need to include a beneficiary provision in the contract. Since the private annuity is a transfer for value, it is not subject to the Medicaid transfer penalties.

Example: A married couple has \$200,000 of countable assets. After the institutionalized spouse enters a nursing home, they transfer \$100,000 to their son in exchange for a private annuity. Assuming an AFR of 7.2% and an age for the community spouse of 75 and monthly payments, under the private annuity their son would pay to the community spouse the sum of \$1,239 per month. The community spouse's life expectancy would be 12.5 years. Assuming the cost basis of the \$100,000 transferred was \$100,000, the total annual payment would be \$14,873 of which \$8,000 would be tax-free and \$6,873 would be treated as ordinary income to the community spouse. The calculation is as follows:

¹⁶ 42 U.S.C. §1396p(d)(4)(C).

	\$200,000	Countable Assets
-	\$ 90,660	CSRA to be Retained by Community Spouse
-	<u>\$100,000</u>	Transfer to Son in Exchange for Private Annuity
	\$ 9,340	Remaining Spend Down

A Pennsylvania court¹⁷ has held that the purchase by the institutionalized spouse of a private annuity for the benefit of the community spouse from a trust created by the couple's adult children was a transfer of assets in violation of the Medicaid transfer rules. This is the same court that decided the Dempsey case.¹⁸ Again, the court relied on the Medicare Catastrophic Coverage Act and stated that since the transfer had the effect of providing the community spouse with resources exceeding maximum CSRA, it constituted a transfer without consideration.

The Wisconsin court reached a similar result.¹⁹ In that case the annuity provided for a limited monthly payment at a below-market interest rate with a balloon payment at the end. The annuity was purchased from a limited liability company owned by the annuitant's son and daughter. Both the Pennsylvania case and the Wisconsin case violate the "pig principle." The outcome may have been different if the facts had not been so egregious in each case.

4. Self-Canceling Installment Note (SCIN)

A self-canceling installment note works much the same as a private annuity except that if the parent is still living at the end of the term the payments would stop. The I.R.S. requires that a premium be paid on the interest rate or on the premium on such a note.²⁰ Since the transfer of assets is in exchange for the self-canceling installment note, there is a transfer for value. Therefore, there would be no Medicaid transfer penalty and no violation of the federal criminal provisions.

A Pennsylvania court held that a SCIN was a transfer of assets subject to the Medicaid transfer penalties.²¹ The Medicaid applicant transferred \$61,000 to a trust in exchange for a non-negotiable promissory note in the amount of \$80,000. The Note called for a balloon payment in the forty-eighth month. The court held the transaction to be a transfer. It should be noted that this strategy was

¹⁷Bird v. Pennsylvania Department of Public Welfare, 731 A.2d 660 (June 3, 1999).

¹⁸Dempsey v. Department of Public Welfare, 756 A.2d 90.

¹⁹Steil v. Wisconsin Dept. of Health and Family Services, 2001 WL 1474770 (Wis. Ct. App. 2001).

²⁰Estate of Moss v. Commissioner, 74 T.C. 1239 (1980).

²¹Pyle v. Department of Public Welfare, 730 A.2d 1046 (1999).

extremely aggressive in calling for a balloon payment and when the applicant presented no witnesses at the hearing, no evidence was presented as to the applicant's physical condition. During the first four years the payments were only \$235 per month at approximately 2% interest.

5. Sale of Remainder Interest in Home

As previously mentioned, HCFA Transmittal 64 discusses life estates and provides life expectancy tables.²² A technique can be employed whereby a client sells to a child a remainder interest in the home for the value of the remainder interest, which is often a substantial discount from the fair market value of the home. There would be no penalty, because the transfer would be for value.

Example: A 74-year-old client has a residence assessed at \$100,000. The calculation is as follows:

	\$100,000	Assessment
x	.47851	Remainder Factor
	\$ 47,851	Value of Remainder Interest in Home

The child or children would then pay the parent the value of the remainder interest or \$47,851. The child or children would have received a home valued at \$100,000. This is a transfer for value; therefore, no Medicaid penalty would be imposed.

If the home is sold during the lifetime of the parent, the parent may be entitled to receive the portion of the proceeds of the sale represented by the parent's life estate. This would be measured by the value of the life estate at the date of the sale.

6. Care Agreement

Care agreements are also discussed in HCFA Transmittal 64.²³ The pertinent section reads in part: "While relatives and family members legitimately can be paid for care they provide to the individual, HCFA presumes that services provided for free at the time were intended to be provided without compensation."²⁴ The presumption is rebuttable. States may require that a payment arrangement had been agreed to in writing at the time services were provided.

²²HCFA Transmittal 64 §3258.9A.

²³HCFA Transmittal 64 §3258.1A.

²⁴*Id.*

Often, children bring a parent into the home of the child until such time as the parent is ready to enter a nursing home. In many cases, the child must modify his home in order to make it adaptable to the needs of the frail parent. In drafting a care agreement, reimbursement for expenses made by the child to modify the home should be covered. Expenses in maintaining the home may also be included. Presumably, Medicaid will accept any reasonable formula. One formula would be to total the cost of operating the home, including real estate taxes, water, sewer, utilities, homeowner's insurance premium, condominium fees, and any other shelter-related expenses, and divide by the number of persons living in the home, including the client. Food, medical, and other expenses could be paid directly by the client. For example, a potential Medicaid recipient is single and frail, but would be able to stay out of a nursing home with assistance. His son agrees to move him into the son's home and care for him. The level of care will be similar to that provided by an assisted living facility. Therefore, the potential Medicaid applicant may pay the son a reasonable amount for care (i.e., \$2,500 per month). A portion of the payment is for care; a portion is for rent. The potential Medicaid applicant should also pay the son the cost of meals and prescriptions.

7. Lifecare Contract

It may be possible for a parent to transfer his assets to a child in exchange for lifetime care by the child for the parent.²⁵ One alternative would be to take the position that, at the time the contract was entered into, the parties had no idea as to the length of time for which the child would care for the parent and, therefore, the entire value of the assets transferred from the parent to the child would be "for value." A more conservative approach would be to argue that the child is entitled to monthly compensation at a rate similar to that charged by an assisted living facility in the area. The assets would be transferred from the parent to the child, and the child would earn those assets in accordance with the monthly rate established in the care agreement. The rate must be reasonable. If the parent entered a nursing home prematurely, the child would retransfer any excess assets to the parent.

²⁵See Thomas v. Florida Dep't of Children & Families, 707 So.2d 954 (Fla. Dist. Ct. App. 1998).

8. Family Reverse Mortgage

Often, children are advancing monies to their parents on a monthly basis to enable the parents to meet the shortfall between income and living expenses. If the children secure the advances with a reverse mortgage and a parent subsequently needs to apply for Medicaid, the monies advanced by the child to the parent are secured by a lien on the parents' property. Medicaid subsequently requires that the home be sold for the parent to become eligible for Medicaid. The child can be repaid since there is a lien against real estate. The child should be careful to keep canceled checks or other evidence of loan advances to the parent. The documentation for the loan is similar to that of a line of credit in that the child agrees to advance to the parent certain sums of money on a regular basis, and the parent has no current obligation to repay the money to the child. Interest on all advances accrues at an agreed-upon rate. The I.R.S. §7520 rate may be appropriate. The loan is repaid when the property is sold or when the parent dies.

9. Interest Only Note

Some states, such as Florida, permit a parent to transfer assets to a child in exchange for an interest only note for a period of time. For example, a parent with \$100,000 of liquid assets would transfer the liquid assets to the child in exchange for a non-assignable Promissory Note from the child to the a parent in the amount of \$100,000, bearing a market rate of interest. The child would make monthly payments of interest, but the principal would not be due until the end of the term of the Note. The term of the Note would not exceed the actuarial life expectancy of the parent.

However, in a recent Ohio case, this technique was held to be a transfer of assets subject to the Medicaid transfer penalties.²⁶

e. Transfers Subject to Penalty

There are three ways to transfer assets involving the look-back and transfer penalty.

²⁶Notarian v. Ohio Department of Human Services, 2000 Ohio App. LEXIS 5468 (November 22, 2000).

1. Large Transfer of Assets

If an individual has a large estate, it is sometimes wise to transfer a substantial amount of assets to children. This is true if the amount of assets far exceeds what can be sheltered by the Community Spouse Resource Allowance or if the person making the transfer is single. This strategy relies on transferring assets and not applying for Medicaid until after the expiration of the look-back period. Therefore, if the assets are transferred, an application of Medicaid is not made until after the expiration of the look-back period, and no penalty is imposed. The look-back becomes the effective maximum penalty.

2. Half-a-Loaf Transfer

One of the most commonly used techniques in Medicaid planning is the half-a-loaf transfer. Under this technique, the client transfers assets to children and incurs a Medicaid penalty. However, the client retains sufficient assets in his own name to pay for the nursing home during the period of ineligibility. A technique is to transfer a portion of the excess funds to the children. The patient retains sufficient assets to pay for the nursing home care for the penalty period.

In order to determine how much money can be transferred, the monthly nursing home cost must first be calculated. To be conservative, the net monthly nursing home cost is estimated at \$3,000 per month after applying Social Security and pension income. The monthly nursing home cost is calculated as follows:

	\$ 4,200	Monthly Nursing Home Cost
-	<u>\$ 1,200</u>	Social Security and Pension
	\$ 3,000	Net Monthly Nursing Home Cost

In this case, the calculation would work as follows:

	\$100,000	Countable Assets
-	<u>\$ 50,000</u>	Amount Transferred
	\$ 50,000	Amount Retained
	\$ 50,000	Amount Transferred
÷	<u>\$ 3,000</u>	Average Cost of Nursing Home
	16.66	Months - Period of Ineligibility
	\$ 3,000	Net Monthly Nursing Home Cost
x	<u>16.66</u>	Months of Ineligibility
	\$ 50,000	Total Cost of Nursing Home

	\$ 50,000	Amount Retained
-	<u>\$ 50,000</u>	Total Cost of Nursing Home
	\$ - 0 -	Balance

In practice, the transfer is never one-half of the assets. The practitioner needs to calculate the cost of the nursing home, the cost of the living expenses of the community spouse, and subtract the total net income to determine the net nursing home cost.

Conservatively, the application must not be made until after the expiration of the 16.66 months of ineligibility. If the potential Medicaid applicant transferred the money in January 2002, application for Medicaid should not be made until May 1, 2004. Each practitioner must make a determination as to whether or not delaying application for Medicaid until after the expiration of the penalty satisfies the federal criminalization provisions, or whether such provisions are any longer relevant. By delaying application, no period of ineligibility would be imposed, and there would be no transfer penalty and no possible violation of federal criminal provisions.

3. Monthly Transfers

In states that do not have a partial month penalty, there is no penalty for any transfer of less than the average cost of a semi-private room in a nursing home, which in the above example is \$3,000 per month. In those states the ineligibility period is applied only in whole months. Assuming the state began the period of ineligibility for the transfer in the month in which the transfer was made, if the client were to transfer \$3,000 per month, the penalty would always be one month and would expire on the first day of the following month. In those states, if a client were to transfer \$2,900 per month, there would never be a Medicaid penalty incurred. So that the client does not forget to make the transfer, an automatic withdrawal arrangement can be made with the client's bank account. The monies would automatically be withdrawn on the first of every month and deposited in the name of the child or children to whom the transfer is to be made.

4. Transfer Home and Retain Life Estate

Under this technique, the client transfers a remainder interest in the home and retains a life estate for the client. One of the benefits of this technique is that clients are comfortable in doing it. The penalty would then be calculated on the value of the remainder interest, which is transferred to the child. The Medicaid value of the home must first be calculated. Assume an assessed value of \$100,000 and an age of 74. The calculation looks like this:

	\$100,000	Assessment
x	<u>.47851</u>	Remainder Factor
	\$ 47,851	Value of Remainder Interest in Home
÷	<u>\$ 3,000</u>	Average Monthly Cost of Nursing Home
	15	Months - Period of Ineligibility

If the life estate had not been retained, the penalty would be calculated as follows:

	\$100,000	Amount of Transfer
÷	<u>\$ 3,000</u>	Average Monthly Cost of Nursing Home
	33.33	Months - Period of Ineligibility

By reserving the life estate, the penalty has been significantly reduced.

In states with narrow definition of estate, there is no estate recovery against a life estate.²⁷ In New Jersey there is no estate recovery against life estates created by deed. In other states, an attempt may be made to recover against the value of the life estate. The issue then

²⁷ States with a narrow definition of estate include: Alaska (Alaska Stat. §47.07.055); Arizona (Ariz. Rev. Stat. §36-2935); Arkansas (Ark. Code. Ann. §20-76-436); California (Cal. Welf. & Inst. Code §14009.5) (includes distribution by survival); Colorado (Colo. Rev. Stat. Ann. §26-4-403.3); Connecticut (Conn. Gen. Stat. Ann. §17b-93); Delaware (Del. Code. Ann. tit. 25, §§5001, 5003); District of Columbia (D.C. Code Ann. §3-214.1) (real personal property-estate); Florida (Fla. Stat. Ann. §409.910) (except no trust, getting agreement shall impair department's rights); Georgia (Ga. Code Ann. §49-4-147.1); Hawaii (Haw. Rev. Stat. §346-37); Indiana (Ind. Code §12-15-9-5) (probate estate); Iowa (Iowa Code Ann. §249A.5) (only recover incorrectly paid assistance); Kentucky (Ky. Rev. Stat. Ann. §205.624); Louisiana (La. Rev. Stat. Ann. §46:153); Maryland (Md. Ann. Code art. 88A, §77); Massachusetts (Mass. Gen. L. Ann. Ch.118E, §32); Michigan (Mich. Comp. L. Ann. §400.106); Minnesota (Minn. Stat. Ann. §514.981, 256B.15) (estate or spouse's estate); Mississippi (Miss. Code Ann. §43-13-317); Nebraska (Neb. Rev. Stat. §68-1036.02); New Mexico (N.M. Stat. Ann. §§27-2A-3, 27-2A-4) (estate and real property); North Carolina (N.C. Gen. Stat. §§108A-70.5, 28A-15-1); Ohio (Ohio Rev. Code Ann. §5111.11); Oklahoma (Okla. St. Ann. tit. 63, §5051.3); Pennsylvania (62 Pa. Cons. Stat. §1412); Rhone Island (R.I. Gen. Laws §40-8-15); South Carolina (S.C. Code Ann. §43-7-460) (probate estate); South Dakota (S.D. Codified Laws §§28-6-23, 28-6-24) (any real property interest); Tennessee (Tenn. Code Ann. §71-5-116) (estate); Vermont (Vt. Stat. Ann. tit. 33, §§122, 2113); Virginia (Va. Code Ann. §§32.1-326.1, 32.1-327); West Virginia (W. Va. Code §9-5-11c).

becomes, what is the value of the life estate at the moment of death? Some states take the position that the life estate is valued immediately prior to death. This is an opportunity for advocacy by an elder law attorney. For example, an elder law attorney should become involved in the legislative process dealing with the issues of estate recovery. If the legislation is already passed, the attorney might become involved in the process of spelling out regulations to implement the legislation. This is where the issue of the value of the life estate will rise. By becoming involved with the state bar association and building a coalition with other senior organizations, an attorney can be effective in this area.

Another issue in this area concerns income and expenses. A life tenant has the right to collect income and the obligation to pay expenses. If the property is rented while the life tenant is in a nursing home, the net income from the rental should be income attributable to the life tenant for Medicaid income eligibility purposes. However, this can be changed by contract. The deed can spell out the terms of the life tenancy.

f. Miscellaneous Planning Strategies

1. Divorce

There are situations in which, from a financial standpoint, divorce is a viable option. However, before counseling a client to pursue this course, the attorney must make a determination as to the emotional damage that may be done. Generally, a divorce would be financially desirable if a family court would award equitable distribution to the community spouse, which would exceed the Community Spouse Resource Allowance. If the couple had countable assets in excess of \$185,520, under Medicaid eligibility the community spouse would receive only \$92,760 in 2004. Under equitable distribution, the community spouse should receive at least half. Where couples have modest resources, the CSRA, coupled with other planning techniques, may be adequate to shelter sufficient assets. Where a community spouse has substantial separate property, a divorce will often result in more resources for the community spouse. This would be true if the community spouse had received a large inheritance. Another situation in which to consider divorce as a planning option is where the institutionalized spouse has a large portion of assets in a retirement account. These assets can be moved tax free to the spouse through a Qualified Domestic Relations Order incident to a divorce. Whenever a divorce is considered, each spouse should obtain separate legal counsel. Perhaps, both spouses should obtain legal counsel separate from the attorney doing the Medicaid planning. Before counseling a

divorce, the attorney must explain that divorce has implications for estate planning, income taxes, insurance, Social Security and pensions. These implications must be explored before pursuing a divorce.

As the result of the adoption of the income-first rule in many states, divorce may be a planning option that is more often considered by elderly clients. However, many states are refusing to recognize divorces that it considers to have been obtained for Medicaid purposes.

2. QDRO

Under federal law, pensions are subject to equitable distribution. Under ERISA, a Qualified Domestic Relations Order (QDRO) can be used to divide pension income.²⁸ The New Jersey Supreme Court, for example, has recognized QDROs as a valid method of changing ownership of pension income for Medicaid purposes.²⁹

A QDRO is an excellent Medicaid planning technique in situations where a significant portion of the couple's assets are in a qualified retirement plan for the benefit of the institutionalized spouse. Typically, these are IRA accounts. If the money is removed from the IRA, the withdrawal is taxable. However, by utilizing a QDRO money can be transferred to a retirement plan for the community spouse maintaining the tax deferral. The QDRO is a Domestic Relations Order recognizing the right of a spouse, former spouse, child, or other dependent as an alternate payee to a participant's benefits under an ERISA qualified plan.³⁰ The criteria for a valid QDRO are set forth in I.R.C. §414(p)(2) and ERISA §206(d)(3)(C). Assignments of military retirement benefits, railroad retirement benefits, and civil service benefits are treated as if made pursuant to a QDRO under federal tax law.³¹ QDROs may also be used for tax-qualified retirement plans, tax-sheltered annuities,³² as well as employer stock bonuses and profit-sharing plans.³³

3. Life Insurance

Certain steps need to be taken in connection with life insurance policies.

i. Change life insurance beneficiary

²⁸ I.R.C. §414(p)(1)(A)(i).

²⁹ L.M. v. DMAHS, 140 N.J. 480, 659 A.2d 450 (Sup. Ct. 1995).

³⁰ ERISA §206(d)(3); I.R.C. §414(b)(1)(A); Treas. Reg. §1.401(a)-13(g)(1).

³¹ I.R.C. §414(p)(11).

³² I.R.C. §401(a)(13), 414(b)(9).

³³ I.R.C. §401(a)(13)(A) & (B).

Frequently, a husband and wife have life insurance policies naming each other as beneficiary. If one spouse enters a nursing home, the beneficiary of the policy on the community spouse should be changed to the children. Otherwise, the proceeds would be paid to the spouse in the nursing home and that spouse's Medicaid eligibility would be lost. The funds would then have to be expended for nursing home care, prior to reapplying for Medicaid. Never name the estate of the Medicaid recipient as beneficiary of the life insurance policy, or the proceeds will be subject to estate recovery.

ii. Assign life insurance policy

Assign the life insurance policy to the community spouse without penalty, to a funeral director as full or partial payment for a prepaid funeral without penalty or to a child with a penalty.

iii. Borrow cash value of life insurance policy

Certain policies, such as VA life insurance policies, are non-assignable. The strategy there is to borrow out the cash value, transfer it to the children or spend it down so that the policy has no cash value at the time of the Medicaid application. By employing this strategy the Veteran will not have to cash in the policy and lose the difference between the cash value and the death benefit.

4. Retirement Plan

i. Retirement plan beneficiary of the institutionalized spouse

The best strategy with respect to the retirement plan of an institutionalized spouse is to spend it for nursing home care. The care is tax deductible and offsets the income from the withdrawals from the IRA.

ii. Retirement plan of the community spouse

(1) Use for care

To the extent additional funds are needed for care consider using the retirement plan of the community spouse. Again, the medical deduction will offset the withdrawals.

(2) Change retirement plan beneficiary of the community spouse

A married couple often has separate retirement benefits, such as IRA accounts, on which the other spouse is named a beneficiary. If one spouse enters a nursing home, the community spouse should change the beneficiary on his or her retirement plan to someone other than the institutionalized spouse. Otherwise, the money will be paid to the institutionalized spouse and will simply go to a nursing home. In some instances, spousal consent is required to effectuate such a change of beneficiary. A properly drafted Power of Attorney can be used to accomplish this objective. If the beneficiary is not changed, then upon the death of the community spouse, the institutionalized spouse will receive the assets in the retirement account and be over-resourced. The institutionalized spouse will lose his Medicaid benefits.

5. Annuity

i. Use for care

If either spouse has a deferred annuity, there is likely accrued income that has never been taxed. This is a good opportunity to withdraw the funds and pay for care. The medical deduction for the care will offset all or most of the tax.

ii. Change annuity beneficiary of the community spouse

If a community spouse has an annuity, it typically will name the institutionalized spouse as the beneficiary. These must be changed.

6. Change Will of CTj 11.4218 0 Td (i)Tj 3.3608(l)Tj 3.a

In order to determine the expanded Community Spouse Resource Allowance, we first need to determine the MMMNA.

In the example given in the subsection titled “Excess Shelter Allowance” above, the MMMNA was determined to be \$1,115 plus the Excess Shelter Allowance of \$500, for a monthly shortfall of \$1,615.

What is the amount of resources required to produce \$1,615? This is the amount of the resources to which the community spouse should be entitled. In the example given above, there was a shortfall of \$1,615 per month.

In a Missouri case, Thomas A. Bryant Case No. MO96-15234537, a fair bank rate of interest was used. In our example we use the fair bank rate of interest and let's assume that a fair bank rate of interest for a money market account of 3 percent.

(5) Income first rule

Many states require that the community spouse look first to the income of the institutionalized spouse to satisfy the MMMNA.

The United States Supreme Court in the *Bloomer* case held that the “income-first” method qualifies as a permissible interpretation of MCCA. 122 S. Ct. 962 (2000). The Second Circuit has held that even if a state adopts the Income First Rule, it cannot apply it to Social Security benefits. *Robbins v. DeBuono*, 2000 W.L. 870593 (2d Cir., June 30, 2000). The court held that under 42 U.S.C. §407 Social Security benefits are not assignable and are not subject to execution, levy, attachment, garnishment, or other legal process. The court distinguished Social Security from a pension. The court held that ERISA protected benefits only while they are held by the Plan Administrator, not after they reach the hand of the beneficiary. Therefore, the court applied the Income First Rule to pension plan benefits, but not to Social Security benefits.

In our example, assuming the couple has available resources of \$100,000 and the CSRA is \$50,000, our calculation would look like this:

	\$	IS Income (less Social Security)
-	\$	Personal Needs Allowance
-	\$	Medical Insurance
-	<u>\$</u>	Medicare Part B
	\$	Net IS Income
-	<u>\$</u>	Income on CSRA (\$50,000 @ 3%)
	\$	Available for MMMNA
-	<u>\$</u>	Allowance Available from Income
	\$	MMMNA Deficit
x	<u>12</u>	MMMNA Deficit Months
	\$	Annual Deficit
x	<u> </u>	100 ÷ 3% Annual Rate of Return
	\$	Additional Resource Required

(6) Procedure⁴⁷

Both Federal and State law require a Fair Hearing. This would appear to require an application for an expanded Community Spouse Resource Allowance followed by a denial and a Fair Hearing appeal. An alternative would be to establish the expanded Community Spouse Resource Allowance through a court proceeding. HCFA has taken the position in a recent memorandum that the court proceeding cannot take place until after the determination of the Community Spouse Resource Allowance through the normal Medicaid procedures,

⁴⁷42 U.S.C. § 1396r-5(e).

including the Fair Hearing. In an unreported case, *A.C. v. DMAHS and Burlington County Board of Social Services*, it was held that Petitioner has a right to a fair hearing rather than proceeding in a court of competent jurisdiction.

h. Alternatives to Appeals to Expand CSRA

1. Loans

Another technique to expand the Community Spouse Resource Allowance is through borrowing money. The current Maximum Community Spouse Resource Allowance for 2004 is \$92,760. Therefore, the optimum amount of non-countable resources for a couple to have on the date of the snapshot would be \$185,520. This is because if \$185,520 is divided by two, the result \$92,760.

Suppose a couple has \$100,000 of countable resources. Our calculation would look like this:

	\$100,000	Available Resources
÷	<u>2</u>	
	\$ 50,000	CSRA
	\$ 50,000	Spend Down

Let's suppose this couple could borrow \$85,520 from a child or on a home equity home immediately **prior to institutionalization**. At the time of the snapshot the couple's resources would then be \$185,520. The calculation would then look like this:

	\$185,520	Available Resource
÷	<u>2</u>	
	\$ 92,760	CSRA
	\$ 92,760	Spend Down

The first thing the institutionalized spouse would do would be to repay the loan. The calculation would then look like this:

	\$ 92,760	Spend Down
-	<u>\$ 85,520</u>	Repayment of Loan
	\$ 7,240	Remaining Spend Down

We have, in effect, increased the Community Spouse Resource Allowance by \$42,760 from \$50,000 to \$92,760, and decreased the amount required to be spent down by \$42,760 from \$50,000 to \$7,240.

2. Change of Residence

For persons living near a state that does not count an IRA as a countable asset consider placing the institutionalized spouse in a nursing home in that state. In this way the IRA of the community spouse can be protected and effectively the CSRA expanded.

3. Series EE and Series I Bonds

Series EE and Series I U.S. Savings Bonds cannot be redeemed until six months after the purchase date. Therefore, purchase of U.S. Savings Bonds immediately prior to institutionalization would be an inaccessible resource as of the date of the snapshot. With this strategy where there is a married couple the community spouse might purchase savings bonds one month prior to the institutionalization of the institutionalized spouse. As of the date of the snapshot the bonds will be an inaccessible resource. After the application is approved, the bonds will be redeemed by the community spouse. This technique is supported by the Indiana Medicaid manual⁴⁸ and also is a viable strategy in Florida. If the Medicaid application is not approved until after the six month period from the date of the purchase of the bonds, it is likely that most states would then consider the bonds to be a countable asset.

4. Spousal Refusal

Federal law is reinforced in the New York Social Services Law.⁴⁹

Under federal law⁵⁰ an institutionalized spouse is not ineligible for Medicaid because of excess resources if the institutionalized spouse has assigned to the state any rights to support from the community spouse. Under this technique the institutionalized spouse assigns all assets to the community spouse and the community spouse refuses to make assets in excess of the CSRA available. The institutionalized spouse then assigns his or her right of support to the state.

If the institutionalized spouse lacks the capacity to make the assignment to the state or fails to cooperate with the state, the state has

⁴⁸§2615.45.00.

⁴⁹§ New York Social Services Law §366 (3) (a).

⁵⁰42 U.S.C. §1396r-5(c)(3).

an implied right to bring a support proceeding against the community spouse.⁵¹ Alternatively, spousal refusal would also be effective if a denial of Medicaid would work an undue hardship.⁵²

It should be noted that the state does have a right to recover and may in fact exercise that right.⁵³

Florida has a written policy similar to that of New York⁵⁴ which states, “If the community spouse refuses to make available assets attributed to the institutionalized spouse, the institutionalized spouse may assign the rights of support to the state and obtain institutional care benefits.”

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⁵¹42 U.S.C. §1396r-5(c)(3)(B).

⁵²42 U.S.C. §1396r-5(c)(3)(C).

⁵³Commissioner v. Spellman, 672 N.Y.S. 2d 298 (1st Dept. 1998); Commissioner v. Fishman, 713 N.Y.S. 2d 152 (1st Dept. 2000).

⁵⁴The Florida Integrated Policy Manual §1615.10.30.10.