

MEDICAID PLANNING AFTER REFORM

by Thomas D. Begley, Jr., CELA, AIF
and Andrew H. Hook, CELA, AIF

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 (ADRA).¹ The effect of this legislation has made it more difficult for persons to become eligible for Medicaid. Unfortunately, the federal and state governments save money at the expense of health care for poor and middle-class seniors. Most of the major cutbacks in Medicaid were contained in ' ' 6011 through 6016. This article will examine each section and attempt to analyze which current Medicaid planning strategies are no longer viable and what other strategies may work. A copy of ' ' 6011 through 6016 is attached as Appendix "1."

On July 27, 2006, the Centers for Medicare and Medicaid Services (CMS) issued Guidance to the States.² The purpose of the Guidance is to provide information for states regarding implementation of new rules related to DRA.

' 6011 - LENGTHENING LOOKBACK PERIOD; CHANGE IN BEGINNING DATE FOR PERIOD OF INELIGIBILITY

P **Lookback.** The lookback period is extended to 5 years.

N ***Planning Opportunities Eliminated.*** It is no longer possible to transfer assets and wait three years for Medicaid eligibility.

N ***New Planning Opportunities.***

§ ***Transfer Funds.*** Set aside sufficient funds to pay for five years of care and transfer the balance to children. Include an inflation factor for care. A variation of this strategy is to transfer virtually all of the assets to the children and let the children pay for the parent=s care for 5 years or any portion remaining and claim the parent as a medical dependent on the child=s income tax return.

§ ***Grantor Trust.*** Use Grantor Trusts more frequently. The advantage is that risk factors associated with transferring assets to children are eliminated. ' 121 Exclusion for Sale of a Principal Residence can be retained and a step-up in basis for appreciated assets is available. Income can also be taxed to the grantor.

In situations where the parent is receiving home care or assisted living, less money will need to be spent for care, but the tax deduction to the child will also be less.

¹ Deficit Reduction Act of 2005 (Pub. L. 109-171).

² Center for Medicaid and State Operations SMDL No. 06-018, July 27, 2006.

§ *Buy Long-Term Care Insurance for a 5-Year Period.* Healthy clients could buy long-term care insurance for a period of 5 years. If they need long-term care in the future, they could transfer their assets at that time and wait out the 5-year lookback through the use of long-term care insurance.

P **Beginning Date.** The beginning date of the period of ineligibility has changed from the date the transfer was made to the later of the date of the transfer was made or the date the individual:

- (1) *Resource.* Would be resource eligible for medical assistance; and
- (2) *Medical.* Would otherwise be receiving institutional level care; and
- (3) *Application.* Based on an approved application for such care, but for the application of the penalty period, whichever is later; and
- (4) *Penalty.* Which does not occur during any other period of ineligibility.

Therefore, there seems to be a four-prong test. The period of ineligibility does not begin until the later of:

- (1) *Transfer.* The date of the transfer

OR

- (2) *Resource.* The date the applicant is resource eligible, **and**
- (3) *Income.* The date the applicant is income eligible, **and**
- (4) *Medical.* The applicant medically requires an institutional level of care, **and**
- (5) *Application.* A Medicaid application has been filed, **and**
- (6) *Penalty.* There is no other period of ineligibility outstanding.

PRACTICE TIP: Since the penalty period will not begin until the client is admitted to a nursing home and out of funds, it is likely many nursing home residents will be unable to pay for their care during the resulting period of ineligibility. The Congressional Budget Office estimates that this provision will delay Medicaid eligibility for about 120,000 people per year.³ In these cases, the nursing home will likely sue the resident's children for payment of the cost of care based on "filial responsibility laws", "transfer in defraud of creditor laws" or guarantees of the facility admissions agreement.

CMS Guidance contains several important points:

N Since the penalty cannot begin until the expiration of any period of ineligibility, how are transfers made prior to February 2006 treated?

N States must be aware of the need to provide appropriate denial notice for new applicants so that the penalty period is clearly understood.⁴ Once the penalty beginning date begins, it does not toll if the individual stops receiving an institutional level of care.⁵

N ***Planning Opportunities Eliminated.*** Half-a-loaf transfers.

N ***New Planning Opportunities.***

§ ***Reverse Half-a-Loaf.*** Under this strategy the parent transfers assets, immediately applies for Medicaid, and is rejected. The child then retransfers roughly half the assets to the parent. The parent reapplies and is rejected because of the remaining outstanding transfer. The parent pays for that period of ineligibility from the retransferred funds.

³ <http://www.cbo.gov/ftpdocs/68xx/doc6849/BartonLtrl.pdf>

⁴ Center for Medicaid and State Operations SMDL No. 06-018, , July 27, 2006, §§ 6011 and 6016 II.

⁵ *Id.*

PRACTICE TIP: This strategy will not work in states that do not permit a partial cure. HCFA Transmittal 64 permits partial cures.⁶ It is likely that most states will prohibit partial cures once this strategy is discovered. This strategy is new and untested in New Jersey. However, New Jersey appears to permit partial cures. See DMAHS response to Comment 7 by Janis Chapin, “When part of an asset has been returned the penalty can be modified proportionately, but not eliminated... . The Division will propose amendments to N.J.A.C. 10:71-4.10(b)3 to include specific provisions related to returned assets.” No regulations were ever forthcoming, but partial gifts have been recognized in New Jersey and continue to be so until further notice from DMAHS or CMS.

HARDSHIP WAIVERS

Each state must provide a hardship waiver process for situations when application of the transfer of assets penalty would deprive the individual of: (1) medical care such that the individual's health or life would be endangered; or (2) deprive the individual of necessities of life, such as food, clothing and shelter.

The statute provides that notice must be given by the state that the hardship exception exists, a timely process for determining hardship must be developed, and an appeals process must be provided. All of this is similar to existing law. What is new is that either the individual *or the facility* may apply for a hardship waiver and the state is authorized to pay for nursing facilities services to hold a bed for a period not in excess of 30 days while an application for a hardship waiver is pending.

P **Planning Opportunities Eliminated.** None.

P **New Planning Opportunities.** It may be possible to get better results by having a nursing home file an appeal for hardship waiver.

' 6012 DISCLOSURE & TREATMENT OF ANNUITIES

P **Disclosure.** At the time of a Medicaid application or re-certification of eligibility the applicant must disclose a description of any interest the individual or community spouse has in an annuity. The applicant or re-certification must include a statement that the state becomes a remainder beneficiary under such an annuity.

⁶ HCFA Transmittal 64 ' 3258.10 C 3.

P **Notice.** The state shall notify the issuer of the annuity of the right of the state as preferred remainder beneficiary.

P **Change in Amount.** The state may require the issuer to notify the state when there is a change in the amount of income or principal being withdrawn.

P **Guidance.** The Secretary may provide guidance to states in categories of transactions that may be treated as a transfer of assets for less than fair market value.

P **Denial of Eligibility.** Nothing in the subsection pertaining to disclosures of income and resources derived from an annuity shall be construed as preventing a state from denying eligibility based on income or resources derived from the annuity.

P **State Named as Beneficiary.** Transfer of an annuity shall be treated as a transfers of assets for less than fair market value unless:

N **Remainder Beneficiary.** The state is named as remainder beneficiary in the first position for at least the total amount of medical assistance paid on behalf of the institutionalized individual⁷; or

N **Second Position.** The state is named as a beneficiary in the second position after the community spouse or minor or disabled child and is named in first position if such spouse or a representative of such child disposes of any remainder for less than fair market value.

P **Design of Annuity.** Annuities are not subject to the transfer of assets provisions if:

N it is owned by IRA or purchased with the proceeds from an IRA, an SEP, or a Roth IRA; or

N the annuity is:

§ irrevocable

§ non-assignable

§ actuarially sound as determined in accordance with the actuarial publications of the Office of Chief Actuary of the Social Security Administration; *and*

⁷ 42 U.S.C. §1396p (c)(i)(F)(1) as added by §6012b of the Deficit Reduction Act of 2005 as amended by the Tax Relief and Healthcare Act of 2006 HR6111 § 405b.

N provides for payments in equal amounts during the term of the annuity with no deferral and no balloon payment.

NOTE: The tables published by the Office of the Chief Actuary must be used, rather than the tables in HCFA Transmittal 64.

P **CMS Guidance.**

N ***Annuity as Income or Resource.*** Even if the purchase of an annuity is determined to be exempt from the imposition of the transfer of asset penalties, it can nevertheless be considered income or a resource.⁸

N ***CS Annuity/Beneficiary.*** The Guidance clarifies that an annuity purchased by the Community Spouse must name the state as beneficiary. Of course, the primary beneficiary could still be a minor or disabled child, in which event, the state would be the contingent beneficiary.⁹ It is unclear whether there would be an actual payback unless the Community Spouse received benefits. CMS Guidance says there must be a payback for “medical assistance *paid on behalf of the annuitant.*” (Emphasis added) If the Community Spouse was the annuitant but received no benefits, it would appear there would be no payback.¹⁰ In the following paragraph CMS states, “The state may receive up to the total amount of medical assistance paid on behalf of the *individual.*” (Emphasis added) Again, the interpretation would seem to be that if the Community Spouse received no benefits, there would be no payback. It is likely that many states will not interpret the Guidance that way.

N ***Retirement Account.*** It does not appear that an annuity purchased by a retirement account has to be irrevocable, non-assignable, etc. However, absent these features the annuity would be a countable asset.

N ***CS Annuity/Countable Asset.*** It does not appear that an annuity purchased by a Community Spouse must be irrevocable, non-assignable, etc. Again, the problem would be that absent these features the annuity would be a countable asset.¹¹

P **Planning Opportunities Eliminated.** This provision appears designed to eliminate balloon payments under annuities.

⁸ Center for Medicaid and State Operations SMDL No. 06-018, July 27, 2006, §§ 6012 I D.

⁹ *Id.* at §§ 6012 II B.

¹⁰ *Id.*

¹¹ *Id.* at C.

P **New Planning Opportunities.** In states that had not previously permitted annuities, there may be an opportunity. It should be noted that under DRA the purchase of an annuity is exempt from the transfer of asset penalties. In states that maintain that the annuity is a countable asset because there is a secondary market, the issue is not transfer of assets but availability. Buying an annuity would not be a viable strategy in those states. Does the statute require payback if the annuity is owned by the Community Spouse and the Community Spouse is the annuitant?

PRACTICE TIP: When an annuity is purchased be sure that there is an irrevocable designation of payee and beneficiary to eliminate the value of the annuity in the secondary market.

PRACTICE TIP: Be sure the form of annuity contract has been approved by the State Department of Insurance. Otherwise, Medicaid can make the argument that the right to assign the annuity, to change the payee and to change the beneficiary are important consumer rights. Therefore, the annuity is void.

' **6013 INCOME FIRST**

States must follow the income first rule when calculating an expansion of the Community Spouse Resource Allowance.

Under CMS Guidance states may use any reasonable method in determining the amount of resources necessary to generate adequate income, including adjusting the CRSA to the amount a person would have to invest in a single premium annuity to generate the needed income, attributing a rate of return based on the presumed available rate of interest.

P **Planning Opportunities Eliminated.** In states that followed the resource first rule, it was possible to protect significantly more assets to generate income to satisfy the Community Spouse=s MMMNA. This is no longer possible in those states.

P **New Planning Opportunities.** Practitioners might take the position that the Social Security of the Community Spouse is not assignable in calculating the amount of resources needed to satisfy the MMMNA. *See Robbins v. DeBuono.*¹²

¹² Robbins v. DeBuono, 218 F3d 197 (2d Cir. 2000).

' 6014 HOME EQUITY

P **Limits.** A person is ineligible for Medicaid if he has equity in the home in excess of \$500,000 or at state option \$750,000. This number is indexed for inflation.

EXCEPTION: The maximum amount does not apply if the home is occupied by:

§ spouse

§ child under age 21

§ child who is blind or permanently and totally disabled

P **Loan.** The applicant is encouraged by the Act to obtain a reverse mortgage or home equity loan to reduce equity.

P **CMS Guidance.** CMS Guidance is somewhat confusing in that it contains the following, “NOTE: This is not a change in the general rule that excludes a home of any value for purposes of determining eligibility for Medicaid. It applies only to medical assistance payment for nursing facility services, or other long-term care services as defined above.”¹³ It would appear that this note applies only to community Medicaid rather than institutional Medicaid.

P **Planning Opportunities Eliminated.** The perceived abuse was that Medicaid applicants were using their assets to buy million dollar homes to become immediately eligible for Medicaid. In fact, this section will have very little effect on Medicaid planning, because in most states if the Medicaid applicant is single the home would either have to be sold for the applicant to be granted Medicaid or the home would be subject to Medicaid estate recovery on the applicant=s death.

P **New Planning Opportunities.** The DRA does not affect home occupied by the Community Spouse. The new planning opportunity is for practitioners to do exactly what this provision was intended to eliminate. Since easy Medicaid planning opportunities, such as transfer assets and wait three years or half-a-loaf transfers, are no longer available, Community Spouses might want to consider buying more expensive homes as a means of sheltering assets.

' 6015 CCRC CONTRACTS

P **Transfer Provisions.** Provisions in CCRC contracts restricting transfers of assets are enforceable.

¹³ *Id.* at §6014 I.

PRACTICE TIP: It is foreseeable that the nursing home industry will lobby for similar authorization to contractually restrict transfers of assets disclosed on admission agreements.

P **Entrance Fees.** Entrances fees are countable assets if:

N the contract provides that the entrance fee may be used for care; or

N the individual is eligible for a refund; and

N the entrance fee does not confer an ownership interest.

P **CMS Guidance.** The Guidance clarifies that a Community Spouse living in a CCRC is entitled to a Community Spouse Resource Allowance.¹⁴

P **Planning Opportunities Eliminated.** Many practitioners ignored the restrictions in CCRC contracts prohibiting transfer of assets. This strategy is no longer viable.

P **New Planning Opportunities.** None.

' 6016 ADDITIONAL REFORMS OF MEDICAID ASSET TRANSFER RULES

P **Partial Month Penalties.** Partial month penalties are mandated.

N **Planning Opportunities Eliminated.** It is no longer possible for Medicaid applicants to transfer small sums of money, lower than the state divisor, to escape the imposition of a penalty. Nor it is possible any longer to transfer assets and then make additional transfers within the lookback period structured in such a fashion that the penalty for those subsequent transfers did not extend beyond the original lookback period. This was a very useful strategy in dealing with retirement accounts.

N **New Planning Opportunities.** None.

P **Accumulation of Multiple Transfers.**

N Fractional transfers of assets in more than one month are accumulated.

¹⁴ *Id.* at §6015 I.

N Transfers during all months are treated as one transfer.

§ *Planning Opportunities Eliminated.* The effect of this statute is to penalize all transfers made within the five year lookback period. It is no longer possible to make a small transfer and wait until the penalty expires before applying for Medicaid.

§ *New Planning Opportunities.* None.

P **Notes and Other Loan Assets.** For transfer of assets purposes promissory notes, loans and mortgages are included unless:

R they include an actuarially-sound repayment term as calculated by the Office of the Chief Actuary of the Social Security Administration (the tables are attached as Appendix “2”); and

R payments are made in equal amounts with no deferral or balloon payment; and

R the document prohibits the cancellation of the balance upon the death of the lender.

N *Planning Opportunities Eliminated.* It is no longer possible to use a private annuity or a SCIN. Most state courts took the position that transfers and exchanges for private annuity and SCINs constituted a transfer of assets in any event.

N *New Planning Opportunities.* Transfer of assets from a Medicaid recipient or Community Spouse to children in exchange for a promissory note are clearly exempt from the Medicaid transfer of asset penalties. The note should be actuarially sound, use equal *monthly* installments to avoid violating the Pig Principle, bear a market rate of interest, and include a clause prohibiting cancellation of the indebtedness or the death of the lender.

PRACTICE TIP: The note should contain a provision that it is non-assignable, that the lender cannot demand prepayment, and that the borrower cannot make prepayment.

It may be that states will take the position that there is a secondary market for non-negotiable promissory notes and that they are, therefore, countable assets. This issue is likely to be litigated going forward.

P **Purchase of Life Estates.** The purchase of a life estate is not considered to be a transfer of assets if the purchaser resides in the home for a period of at least one year.

- N **CMS Guidance.** The CMS Guidance has some troubling language, “Unless a state has a provision for excluding the value of life estates in its approved State Medicaid plan, or the property in which the individual has purchased the life estate *qualifies as the individual’s exempt home*, the value of the life estate should be counted as a resource in determining Medicaid eligibility.¹⁵
- N **Planning Opportunities Eliminated.** This provision was intended to stop abusive situations where a parent transfers money to a child with no intention of ever moving into the child’s home is not a viable option. There is now a bright line test of one year residency for the parent in the child’s home for this strategy to be viable.
- N **New Planning Opportunities.** In many instances a parent moves into the home of a child and lives there for the rest of the parent’s life. Typically, the institutionalized spouse goes to a facility, and the community spouse moves in with a child. As long as the community spouse lives there for one year, the community spouse could purchase the life estate from the child. Since the child’s home would then qualify as the Community Spouse’s exempt home, the life estate should not be a countable resource.

The same strategy may apply to a single individual who may live with a child for a period of time and then have to move to a nursing home. The problem here is the language in the CMS Guidance.

The capital gains tax consequences to the parent and the child must be considered. It would appear that the sale of the life estate would be subject to the child’s Section 121 Exclusion from Capital Gains Tax on the Sale of a Principal Residence.¹⁶ If the property is sold during the lifetime of the parent, the gain would be recognized and taxed to the parent and child in their individual capacities.¹⁷ The parent should be able to use the 121 exclusion if the parent is occupying the residence as his home and satisfies the holding periods. On the death of the parent the child will not receive a step-up in basis since the life estate was not a retained interest, but was purchased.

¹⁵ *Id.* at §§ 6011 and 6016 IV.

¹⁶ I.R.C. § 121

¹⁷ Rev. Rul. 71-122 and FTC 1-2917.

PRACTICE TIP: In most cases, the child will have a mortgage on the home. The mortgage will contain a Due on sale clause. The Garn-St. Germain Act applies to transfers of an interest in real estate and makes an exception only for transfers to spouses and children, not to parents.¹⁸

Other planning opportunities that may become more widely utilized are divorce and care agreements.

P **Divorce.**

- N ***Equitable Distribution.*** It is likely that more couples will be divorced so that the community spouse receives equitable distribution, which may exceed the Community Spouse Resource Allowance.
- N ***Alimony.*** It may be possible for the community spouse to obtain alimony that may exceed the Minimum Monthly Maintenance Needs Allowance (MMMNA).
- N ***Arm=s Length.*** The divorce must arm=s length, each party must be represented by separate counsel and the agreement must be on the record and approved by a court after testimony.
- N ***QDRO.*** Consider a QDRO if retirement funds are being transferred from the institutionalized spouse to the community spouse.

P **Care Agreements.** Children often provide significant care to parents. It is possible to compensate the children for such care. There must be a Care Agreement. The Care Agreement must be in writing, must be prospective in nature and the compensation must be reasonable. This may arise in several different situations:

- N ***Parent=s Home.*** Sometimes the child moves into the parent=s home and provides the care there.
- N ***Child=s Home.*** Sometimes the parent moves to the child=s home and receives care there.
- N ***Separate Residences.*** In certain instances the parent and child live separately, but the child provides certain services to the parent.

¹⁸ 12 U.S.C. § 1701 J-3.

- N **Direct Care.** Child provides care.
- N **Care Coordination.** Child coordinates or manages the delivery of services to parent.
- N **Single Clients.** May be used for single clients.
- N **Taxable Income.** Income taxable to child.
- N **SS and Medicare Withholding.** Child receives \$1,500 + per year.
- N **FUTA Withholding.** Child receives \$1,000 or more in any calendar quarter.
- N **Federal Income Tax.** Withholding not required absent agreement.
- N **Value of Services.** Document value of services.

EFFECTIVE DATE

There is considerable confusion as to the effective date of the new rules. The effective date could be:

- § the date of enactment of the Deficit Reduction Act of 2005
- § the date of the adoption by the state of implementing legislation
- § the date of adoption by the state of implementing regulations

| |
|--|
| <p><u>PRACTICE TIP:</u> Any new state statute and/or regulations may be effective retroactive to the date of the federal legislation.</p> |
|--|

Small transfers until the date of the enactment of any new state statute or regulation may be a viable strategy, but only if the client's completed Medicaid application is filed with Medicaid before the state enacts new statutes and/or regulations.

Appendix

1. Pertinent Provisions – Deficit Reduction Act 2005 §§ 6011-6016
2. Chief Actuary Tables