

SPECIAL REPORT

Medicaid Planning

Roughly 50% of healthy Americans age 65 will eventually require some form of long-term care. This care can be nursing home care, assisted living or home care. Whatever the setting, the care is extremely expensive. Nursing homes, for example, can easily cost in excess of \$100,000 per year.

HOW TO PAY

There are five ways to pay for long-term care.

- **Private pay:** The first way is called private pay, which is the worst way, you simply write the provider a check.
- **Long-Term care insurance:** The best way to pay for long-term care is to purchase long-term care insurance. Only about 8% of the people in the country have bought long-term care insurance. It is something people really ought to look into, when they are about 50 years old. At that point it is relatively inexpensive, although it is not cheap, also at that age people tend to be insurable. By the time people reach the age of 65, 25% are not insurable.
- **Medicare:** The third way to pay for long-term care is through Medicare. Medicare pays for some home care for people who

are homebound, and it pays part of a hundred days in a nursing home if the people are receiving skilled care.

- **Veterans Administration:** The Federal Veterans Administration pays for long-term care, but it is limited. Some states have state veterans programs. VA programs probably pay for less than 1% of all of the long-term care being delivered in the United States.
- **Medicaid:** The fifth way is Medicaid, which pays for over half of all the long term care bills in the United States.

MEDICAID MYTHS

There is a lot of misinformation about Medicaid, and it's a shame. There are seven Medicaid myths.

- 1) **Three-Year Lookback:** The first myth is that people can give away their assets and wait three years and become eligible for Medicaid. Under prior law that was true. Under the Deficit Reduction Act of 2005 the lookback has now been increased to five years.
- 2) **Half-a-Loaf:** The second myth is that people can give away roughly half their assets and retain the other half to pay for their care. It was possible prior to DRA, but is no longer

possible. Any gift will result in some penalty under the current law.

- 3) **The Home is Protected:** The third myth, and this is a huge one, is that the home is protected. There are two points of contact with Medicaid. The first one is the time of the Medicaid application. At that point if the sick spouse is in a nursing home and the healthy spouse is living in the home, the home is protected. But in about half of the states, when the sick spouse dies Medicaid places a lien on the home. So the home is really not protected at that second point of contact, which is called Medicaid Estate Recovery.
- 4) **The IRA is Protected:** Another myth is that the IRA is protected. In a few states such as Pennsylvania, the IRA of the spouse staying home is protected but in all states including Pennsylvania the IRA of the institutionalized spouse is just an asset like any other asset. Steps have to be taken to protect that IRA.
- 5) **An Account in Joint Name is Protected:** Another myth is that an account in joint name is protected. Mom sets up an account and adds her daughter as a joint owner. She thinks all of that money is the daughter's money. Under Medicaid if an account requires only one signature for withdrawal, that account is not protected. Mom can still take the money out by herself, so Medicaid says it is her money, take it out and use it for care. If it is an "and" account, Mom and her daughter, and two signatures are required. Then Medicaid says a transfer was made, a gift, as of the time that joint account was opened. It's a gift of half.
- 6) **There is No Hurry to Begin Medicaid Transfers:** In many situations it is best to transfer assets as soon as possible because the clock will begin to run on the five-year look-back.
- 7) **I can give away twelve thousand dollars**

per person per year without a penalty: That is gift tax law. A person can give away twelve thousand dollars per person per year without paying any gift tax, but there is still a Medicaid penalty. Under the gift tax law an individual is also allowed to give away \$1 million during his or her lifetime. Again, there is still a Medicaid penalty.

GOALS

Many clients seek the advice of elder law attorneys in order to become eligible for Medicaid or other public benefits to help the client pay for the long-term care that they need and avoid bankrupting the family. Most people have five goals:

- **Best quality of care:** Number one is usually to get the best quality of care for the person receiving the care.
- **Maintain standard of living for community spouse:** The second goal that most families have is more difficult to achieve. They want to maintain the standard of living for the spouse remaining at home. The spouse wants to live in the same home that she has been living in. She wants to be able to afford to pay the taxes, the insurance, maintenance expenses, etc. If too much money goes to pay the nursing home, the community spouse will not be able to afford to live at home.
- **Avoid burdening children:** Most parents do not want to become a financial burden on their children, and this can happen if planning is not done properly.
- **Legacy:** Most parents want to preserve a legacy for their children, if they don't need the money for themselves.
- **Avoid Lien on Home:** People do not want to have Medicaid place a lien on their home, which happens if proper planning isn't done.

WHO IS A TYPICAL MEDICAID PLANNING CLIENT?

Typically our client is a middle class person. Poor people qualify for Medicaid automatically because they are poor. Wealthy people generally choose to be cared for at home and they can afford to pay the thirty five hundred or four thousand dollars a month that it costs.

WHAT ARE THE RULES OF FINANCIAL ELIGIBILITY?

A person who is planning for Medicaid generally can keep about two thousand dollars. That will vary slightly from state to state, but not much. If there is married the spouse staying in home is entitled to keep a Community Spouse Resource Allowance (CSRA). The maximum CSRA is roughly one hundred thousand dollars and it is indexed to inflation and it increases on January 1st of every calendar year. All the other money has to be spent down one way or another before the sick spouse is going to be entitled to Medicaid. If Dad goes to a nursing home, Medicaid takes a snapshot of the couples resources as of the first moment of the first day of the first month that Dad goes into a nursing home. So he goes in on the 10th of the month, Medicaid goes back to midnight on the first of the month. Whatever the couple had then, that's what Medicaid considers the snapshot amount. From that the spouse staying at home can keep half in some states with the maximum of about one hundred thousand dollars and a floor of about twenty thousand dollars. In other states the community spouse is automatically allowed to keep all of the assets up to the hundred thousand dollars maximum.

WHAT ASSETS DOES MEDICAID COUNT?

Medicaid counts everything except what is explicitly non-countable. Non-countable assets include:

- Home: Medicaid does not count a home as long as it is occupied by the community spouse or by a child under 21 or a child of any age who is blind or disabled. Most states

do count the home if it is not occupied by a member of that protected class. If the person were receiving Medicaid at home, then the home is not counted at the time of Medicaid eligibility, but may be included in the person's estate at the time of Medicaid Estate Recovery.

- Automobile: Medicaid does not count one automobile.
- Personal effects: Personal effects like clothing, furniture, and jewelry of modest value are not counted.
- Prepaid funeral: A prepaid funeral is not counted.
- Cash value of life insurance: Cash value of life insurance is not counted as long as the face value is fifteen hundred dollars or less.
- Personal Needs Account: Medicaid does not count a personal needs account of two thousand dollars or less.

WHAT ARE SOME TYPICAL MEDICAID PLANNING STRATEGIES?

Let's suppose a typical couple has three hundred thousand dollars of countable assets. The healthy spouse is permitted to keep approximately one hundred thousand dollars of those assets. The other two hundred thousand dollars of assets must be disposed of before the sick spouse will be eligible for Medicaid. One choice that is obviously not a good strategy is to give it to the nursing home until the money is exhausted.

There are a lot of ways that people can spend down money, but this is one of the most difficult problems we have with our clients. Our clients tend to have lived through the depression. The reason they have money is because they worked hard, they were thrifty. They were what Tom Brokaw calls the "greatest generation". It's hard for them to adjust their thinking that they have to spend money. You don't spend money just to spend money, you spend it on things that are going to be needed down the road.

- Spend-down: Money can be spent down on many things that Medicaid would approve. For example:
 - Debt: Pay off mortgages, credit card debt, car loans, etc.
 - Payment for services: Pay for services, legal fees and any outstanding doctor bills, any debts that you have.
 - Funerals: Prepaid funerals can be arranged for the Medicaid applicant and spouse and even for adult children; this is a good idea if there is a disabled adult child.
- Convert countable assets to non-countable assets: Convert countable assets to non-countable assets, for example look ahead for the next two to three years and think about what needs to be replaced in the home.
 - Personal effects: Buy those things now like a washer, dryer, refrigerator, new furniture, a new TV, an IPOD would also qualify. We have a list of probably 35 things that Medicaid would approve for spend-down.
 - Home improvements: Many clients are elderly and have occupied their homes for fifty years or more. In many instances, little maintenance has been done. Clients should look around the home and see what needs to be repaired or replaced over the next few years. Like the roof, windows, siding, interior paint, carpet, flooring, etc. Again there is another list of approximately 25 – 35 things that Medicaid would approve.
- Buy new home: A client may want to buy a new home. We had a woman who was renting a condominium and her husband had to go to a nursing home. I said to her, why don't you try to buy a condominium in that complex? So she said funny thing, the landlord was here last week and he wanted to sell me this condominium for one hundred and fifty thousand dollars. I said well buy it, because that is one hundred and fifty

thousand dollars we won't have to give the nursing home. So they had three hundred thousand dollars and the healthy spouse kept \$100,000 as her community spouse resource allowance, and they had to spend \$200,000. The healthy spouse can buy a home in her own name for \$150,000, and then there is only \$50,000 more to spend.

- New car: We could buy a new car. Women never do that, men always do. So I tell people to look around town and see the big yellow hummers that are all driven by men in their eighties whose wives are on Medicaid. They are the only people who can afford it.
- Something for value: The important concept to understand is that Medicaid does not penalize spending money if something of value is obtained by the Medicaid applicant or spouse. If no value is obtained by the Medicaid applicant then the transfer will be subject to a Medicaid transfer penalty, no matter how worthy the purpose. For example a Medicaid applicant cannot open a college account for grandchildren. That is not considered part of spend-down that is considered a gift.

HOW HAS THE DEFICIT REDUCTION ACT OF 2005 (DRA) AFFECTED MEDICAID PLANNING?

Under the Deficit Reduction Act of 2005, which was signed by President Bush on February 8th, 2006, the Medicaid law was dramatically tightened. Old planning opportunities have been eliminated including the idea of giving away one's assets and waiting three years to apply for Medicaid or giving away roughly half of one's assets and reserving the other half to pay for care. Congress and the Administration have put an end to those strategies. However, new planning opportunities have become available. Unfortunately the new strategies are far more complicated than the old strategies and involve more tax considerations and more trusts than in the past.

Under the DRA certain new strategies may be available and old strategies may merit more attention:

- Certain types of annuities
- Certain types of loans
- Special strategies when a parent moves into a child's home
- Divorce
- Agreements for the child to provide care for the parent and be compensated
- Certain types of trusts
- Care Agreements

WHAT IF A PARENT INTENDS TO MOVE IN WITH A CHILD?

A parent can buy the right to live in a child's home for the rest of the parent's life. This is called a life estate. Let's suppose a parent is actually moving in with a child and intends to remain there for the rest of his or her life or as long as that is medically possible. Let's suppose the child has a home with an equity of \$200,000. At age 75 the value of the life estate is roughly \$50,000. Therefore, the parent could pay the child \$100,000 in exchange for a deed from the child permitting the parent to live in the child's home the rest of the parent's life. Since the parent received value for the \$100,000, there would be no Medicaid asset transfer penalty.

- One-year residency: Under the DRA the person buying the Life Estate must live in the home for at least one year. What Congress did in the process is to give us a road map on how you can buy an interest in the home and not be subject to a Medicaid penalty.
- Due on sale clause: The child usually has a mortgage on his or her home, and the mortgage usually has a due on sale clause giving the lender the right to call the mortgage if an interest in the property is transferred. Under the Garn St. Germain Act transfers to spouses and children are exempt from the due on sale clause provisions of a note and mortgage but transfers to parents are not exempt.

- Capital gains tax: The issue of capital gains tax must be addressed. When the child sells the life estate for \$100,000, this would be excluded from capital gains tax under the child's principal residence exclusion from capital gains tax on the sale of his principal residence. If the property is later sold for two years, it would appear that both the parent and the child would receive the principal residence exclusion since it would be the principal residence of each of them.

CAN PARENTS PAY THEIR CHILDREN FOR PROVIDING CARE?

A child can be paid for providing for care for the parent. Sometimes this care is provided by the child moving into the parent's home, sometimes the parent moves into the child's home, and sometimes the care is provided by the child to the parent living in separate homes. Typical care might include driving the parent to doctor's appointments, food shopping, etc. There are three requirements for the parent to pay the child for care. They are:

- Written agreement. The written agreement to provide the care must be in writing.
- Prospective. The payment can be for care provided in the future, not in the past.
- Reasonable compensation. The compensation for the care must be reasonable, which means it has to be no more than what would be paid to a third party to provide the same care.

There are income tax considerations to be addressed. These include:

- Withholding for FUTA
- Withholding for FICA
- Withholding for Federal Income Tax (if the parties agree)

CAN ASSETS BE TRANSFERRED TO A CHILD?

Lookback: Under the DRA, the main thrust was to cut down on transfers of assets. Under prior law there was a lookback of three years. The question on the application read: Have you transferred assets in

the last three years? Now that has been extended to five years.

Beginning date: The more significant change is the beginning date of the penalty for the transfer of assets made during that five-year period of time. If assets are transferred and an application for Medicaid is not made for six years, the transfer would not be disclosed and there would be no penalty. If the transfer is made within five years it used to be that the penalty would start when you did the transfer. So if a person transferred fifty thousand dollars in a state where the average cost of a nursing home was five thousand dollars a month the person would be ineligible for Medicaid for ten months. But if the person went to the nursing home for eleven months the penalty would be over. Now the penalty for transferring the fifty thousand dollars would still be ten months but it wouldn't start until the person went to the nursing home. That is a huge change, and it cuts down on small transfers that were permitted under prior law.

ARE TRUSTS USEFUL IN MEDICAID PLANNING?

Under the new law, we are going to see a lot more assets transferred to trusts. There are five kinds of trusts that I think we are going to see.

- Donee Trust: Transfer assets to the children, and the children then set up a trust for the parent. The trust permits distributions of income and principal to the children but there is nothing to prevent them from writing a check back to the parent.
- Income Only Trust: Under an income only trust the parent receives all of the income, but the principal is paid indirectly through the children. Principal must be distributed only to the children. There is nothing to prevent the children from regifting principal to the parents. There are tax advantages to an income only trust.
- Children's Trust: Using a children's trust, income and principal must be distributed to children. This type of trust avoids risk factors to be discussed later and achieve certain tax advantages.

- Disability Annuity Trust: A disability annuity trust is established for a child who is disabled and receiving SSD, but not for a child who is receiving SSI because the distributions from the trust would disqualify the SSI recipient from receiving public benefits.
- Disability Annuity Special Needs Trust: A disability annuity special needs trust is used where the child is receiving SSI. Distributions from the trust would not disqualify the SSI recipient from receiving SSI and Medicaid.
- Advantages of Trusts: Trusts are advantageous because they reduce the risk of the children losing the money and certain tax advantages can be achieved.
 - Risk Factors: If assets are transferred to children and the children are sued those assets are available to the children's creditors, if the child gets divorced the child's spouse could claim part of the money. If the children are alcoholics or drug addicts, it is not a good idea to put money in their names. If the children have children applying for financial aid to college the assets they are holding for the parent may disqualify the grandchildren from receiving financial aid. I call these "risk factors" by placing the funds in trust these "risk factors" can be avoided.
 - Tax advantages: There are income tax advantages to transferring assets to a grantor trust. This must always be considered when deciding whether to transfer to children or to a trust.

HOW DOES A COMPETENT ELDER LAW ATTORNEY ASSIST A CLIENT?

Over the years the firm has developed a format for dealing with clients.

- Intake form: The first thing we do is send an intake form at the time we make the initial client appointment. The intake form asks the client about health, income, and assets. We ask the client to bring the intake form to the initial appointment.
- Initial appointment: At the initial appointment the first thing to be done is to identify the client goals. It is important that lawyers listen to the clients rather than assuming what the client needs or wants, the client should direct the process. It is the client's money and the client's family, so it is very important that the lawyer listen.
- Tax law: The firm goes over with the client various tax laws that may apply, including gift tax and the fact that there is an income tax deduction for nursing home expense. We explain that if money comes out of an IRA, it is completely taxable. If money comes out of an annuity, there is tax on the deferred income. We explain the tax implications of government bonds. We explain what happens if certain assets are transferred and what the tax consequences will be.
- Medicaid law: The firm then reviews that portion of the Medicaid law that we feel will apply to the client. The client has to get the big picture of how this is all going to work.
- Strategies: Once the client understands the tax and Medicaid law and how it is going to apply in general, we start to walk through the various strategies that are available. There are quite a number of these, roughly 50 strategies for a married couple, and 30 for an individual. We only go over the strategies that would make sense for this client. We give the client as many choices as we can and let the client make the decision. One way to divest assets is to spend down.
- Asset Protection Plan: Once the client has selected the appropriate strategies the law firm should design a plan and deliver it to the client prior to the second meeting. The firm would also prepare any documents that need to be prepared such as wills, living will, powers of attorney, trusts, deeds, agreements

among family members.

- Implementation: Law firms should help the client do what needs to be done to implement the plan. For example, if it is a hefty life insurance policy and the beneficiary needs to be changed, the law firm should assist the client in doing that.

Here are ten important questions to ask yourself with respect to long-term care:

1. Am I willing to risk all that I have accumulated through a lifetime of hard work and frugal living, including my home, my car, and all of my liquid assets to take the trouble to plan for the future?
Yes ___ No ___
2. Do I understand that the cost of planning is insignificant when compared to the cost of paying for long-term care? Yes ___ No ___
3. Do I understand that the risk of my needing some form of long-term care (home care, assisted living, nursing home care) is roughly 50%?
Yes ___ No ___
4. What will that care cost? \$ _____
5. How will I pay for that care if I need it?

6. What will the impact be on my spouse and children if I spend the \$100,000± per year on long-term care? _____
7. Should I explore the possibility of buying long-term care insurance? Yes ___ No ___
If no: Why not? _____
8. Should I hope this problem never arises and ignore it? Yes ___ No ___ Or should I begin to try to protect my life savings now?
Yes ___ No ___ What are my reasons? _____

9. Do I understand that if I become sick it may be impossible for my spouse or children to care for me no matter how much they are committed to doing so? Yes _____ No _____

10. Are my Wills, Trusts, Living Wills, Powers of Attorney and other legal documents up to date? Yes _____ No _____

ABOUT THIS DOCUMENT

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