Note from the Field

Medicaid Planning

Colonel Richard S. Kwieciak
United States Army Reserve

An aging population with increased longevity due to advanced health care, combined with the increasing cost of prolonged health care, has increased the role of Medicaid as an ancillary to estate planning.[1] Your client may be elderly or, more likely, a soldier with an elderly relative who is concerned with saving something for the family when he is facing nursing home care.

Adequate civilian health insurance coverage combined with Medicare will normally cover hospital and doctor charges, but they do not cover prolonged skilled nursing home costs, which can run around $5,000 to $6,000 per month.[2] When insurance runs out or is not available, the program which covers such costs is Medicaid.[3] However, Medicaid requires the applicant to meet certain financial criteria to obtain coverage.[4] Securing the help necessary to care for the elderly relative while preserving assets for a family requires an understanding of Medicaid rules.

Although Medicaid is a federal program, the states administer it, within certain parameters established by the federal statute.[5] Accordingly, each state can have different financial criteria, provided that the criteria rest within the federal parameters.[6] It is imperative to learn the rules within the state where the application for Medicaid is to be made.

Spousal Impoverishment Rules

If the applicant for Medicaid is married and the non-applicant spouse lives at home, the law permits the spouse living at home to retain a certain level of monthly income[7] called the Community Spouse Monthly Income Allowance. New York, for example, permits a spouse to keep $1,976 in monthly income for the year 1997, with additional amounts if dependents reside with the spouse.[8] In addition, the community spouse is entitled to keep some resources called the Community Spouse Resource Allowance.[9] New York permits the spouse to keep a personal vehicle, a principal residence (whatever its value), and an additional $79,020 in other assets.[10] The levels of income and resources can change each year and from state to state.[11] The assets of both spouses are added together to determine the operative values.

"Spending Down" Assets

When there is no community spouse, the applicant must "spend down" his assets to a burial fund before qualifying for Medicaid benefits. To "spend down" means to use up those assets in arms-length transactions. In the application process, the case worker will require the applicant to submit thirty-six months worth of detailed records.[12] The case worker will examine the bank statements for any substantial transfer, usually anything in excess of $1,000. A substantial transfer will

1. 42 U.S.C. § 1396 (1996); Atkins v. Rivera 477 U.S. 154 (1986), 42 C.F.R. §§ 430-56 (1997).

2. Attorneys can obtain updated cost estimates for prolonged skilled nursing home care in New York from the New York Department of Health, Long Term Care Reimbursement, by calling (518) 474-1057.

3. 42 U.S.C. § 1396 (1996); 42 C.F.R. §§ 430-56.

4. 42 U.S.C. § 1396p.

5. *Id.* § 1396a.

6. *Id.* § 1396p.

7. *Id.* § 1396r-5(d)(3).

8. *Id.*

9. *Id.* § 1396r-5(f)(2). The Health Care Financing Administration (HCFA) publishes a memo for its regional offices which sets forth the protected resource amounts.

10. *Id.*

11. *Id.* § 1396r-5(g).

12. The look-back period is three years for outright transfers. However, a transfer into an inter vivos trust extends the period to five years. *Id.* § 1396p(c)(1)(A).

prompt an inquiry into the use of the funds. If they are for the purchase of an item or service for the benefit of the applicant, the inquiry stops. If the transfer is a gift, a penalty period is calculated. These rules exist to prevent applicants from divesting themselves of assets in favor of relatives or friends in order to qualify for Medicaid benefits.

The Look-Back Period and Computing the Penalty Period

The social service department, by federal law, has a "look-back" period of three years.[13] When a person makes an application, he must supply the previous three years worth of all financial records (i.e., bank accounts, bonds, stocks, real estate, mortgages, notes, life insurance, business interests, etc.). If there has been a transfer without full consideration within the three year look-back period, a calculation is made to determine the penalty or ineligibility period for the applicant. The penalty period is determined by taking the value of any gift and dividing it by an amount deemed to be the cost of nursing home care in the area where the application is being made.[14] For example, an application made in the western part of New York State requires the value of the gift to be divided by approximately $4,300, which is the deemed value of nursing home care in that region. The quotient of that equation determines the number of months from the date of the gift that the applicant is ineligible for Medicaid. Accordingly, a gift of $43,000 to a child, or spread among children, will result in about 10 months of ineligibility from the date of the gift.[15]

What About a Living Trust?

The look-back period involving certain trusts has been extended to five years.[16] This rule has made the use of most kinds of "living trusts" ineffective in most Medicaid plans. However, there is a growing industry in which firms invite the public to attend free seminars to avoid attorneys, probate, Medicaid, taxes, and all sorts of other evils by the creation of living trusts. Some clients report having gone to these seminars and being convinced that they would lose everything they owned unless they purchased a living trust.

Many of these "free" seminars are really designed to sell pre-packaged, one-size-fits-all trust instruments. Some of the fees charged for such services are excessive. When asked about such programs, attorneys should determine whether the specific goals and desires of the client are being met by the trust, taking into account income taxes, estate taxes, Medicaid rules, the family make-up, and the ability to handle assets. A trust must be tailored to the client's individual needs and desires.

Further, if a trust is needed or desired, it must be funded to have value. Transferring assets, such as mutual funds, securities, insurance policies, bonds, and real property, into the hands of the trustee(s) is where much of the work lies. In some cases, people have been told that probate would be avoided by the creation of a trust, only to find that the trust was never funded and, accordingly, had no value. The usual excuse given for this outcome is that the clients were told to fund their trusts on their own and that the failure to do so was the clients' fault and not that of the service provider.

The Rule of Halves

Planning around these considerations involves transferring assets. Some of these transfers can be made at the last minute by taking advantage of the local method for computing the ineligibility period. The most common last-minute device is called the "rule of halves."[17] If an applicant gives away some of his assets, but keeps enough to pay his or her own way until the ineligibility period caused by the gift is exhausted, one can safely transfer assets and qualify for Medicaid at the end of the process.[18] For example, a widow who recently suffered a stroke and who had assets totaling $80,000 could probably give away $40,000 or less. The $40,000 retained, along with normal social security and railroad retirement and/or pension benefits, could carry her past the penalty period created when the $40,000 was given away. To compute the penalty period, one needs to know the deemed value of nursing home care in the applicant's locality.

As part of such planning, keep in mind that donors must file a gift tax return if, in the aggregate, the transfers exceed $10,000 per person per year.[19] This is a gift tax rule which must not be confused with the Medicaid penalty period rules. As a practice tip, always have the donor sign and file the gift tax return, if it is possible. This recognizes the potential for a family dispute over the making of a gift where family members did not receive a lifetime gift that would match their intestate (no will) share or a share that would have been received under a will. When the gift tax return is signed by the donor, it becomes

13. *Id.*

14. *Id.* § 1396p(c)(E).

15. *Id.* § 1396p(c)(1)(D).

16. *Id.* § 1396p(c)(1)(B).

17. *See* John J. Regan, Tax, Estate & Financial Planning for the Elderly 10-111 (Matthew Bender, 1996).

18. *Id.*

19. I.R.C. § 2503(b) (1994).

a business record of the Internal Revenue Service that can be retrieved for evidence in court to establish donative intent.[20]

Secrecy in making gifts tends to work against the intent of the donor when such family disputes break out, because the burden lies with a donee to establish donative intent, and the donee is usually barred from testifying in most jurisdictions that have a "dead man" statute.[21] Dead man statutes are rules of evidence which require the court to exclude testimony of any transaction with a decedent when the witness will directly benefit from the testimony given.[22] Therefore, the practitioner must find ways to preserve evidence of a gift so that the gift will not be litigated and declared invalid after the death of the donor.

Real Estate Transfers with Life Use Reserved

An applicant with real property and either sufficient time or other assets to cover the ineligibility period can convey real property to children or others and retain a life estate in the property. Attorneys should note that the value of such a gift is significantly less than an outright gift when computing both the gift and the ineligibility period.[23] Further, such a gift will complicate matters should the client change his mind and desire to sell the property after a transfer is made. First, the co-owners must execute a deed, and they may be unable or unwilling to do so. Second, the elderly client may be entitled to a lifetime exemption of $125,000 for income tax purposes, but the co-owners might not be entitled to the exemption[24] or may not desire to use their lifetime exemption.[25]

If the property is sold, the proceeds become a resource vulnerable to the Medicaid resource rules. Therefore, the strategy of conveying real property and retaining a life estate is best suited to a client who does not intend ever to sell his residence. When using this strategy, clients must not forget to arrange for the new co-owners to be named as additional insureds on the hazard and liability coverage for the dwelling and should make sure that the liability coverage is adequate to protect the new co-owners. Further, clients should be prepared to file a gift tax return on the value of the remainder interest to the new co-owner. The tax trade off, however, is that real estate with a life use is taxable to the life tenant's estate and results in a stepped up basis that will alleviate income tax consequences to the new co-owners when they sell the property.[26]

Life Insurance

Life insurance has an owner, an insured, and a beneficiary. The owner and the insured are not always the same person.[27] A gift of insurance which takes into account the penalty period based upon cash surrender value (not the higher, date of death value) can be part of the plan. To change the owner of a policy, the client needs to obtain the appropriate form from the insurance carrier which allows the owner to assign the ownership to another person.

Not only is this technique appropriate for Medicaid planning, it is an excellent device for estate planning. For estate tax purposes, the insurance will remain includable in the estate of the donor should the donor die within three years of the transfer of ownership.[28] For this reason, if insurance is acquired later in life, make the beneficiary the owner of the policy at the outset. These arrangements may also involve an insurance trust so that the proceeds of a policy might be applied as desired by the donee once the donor has surrendered control of the policy.

Annuities

An annuity is a contract between an annuitant (customer) and an insurance company, whereby the annuitant pays the insurance company a sum of money in exchange for a guaranteed stream of income.[29] If the applicant has an annuity contract that is still accumulating income without paying out, the contract becomes a resource that must be liquidated and spent down.[30] To avoid this consequence, sellers of annuities have recommended that the contract be "annuitized," in other words,

20. 28 U.S.C. § 1731 (1996); N.Y. C.P.L.R 4518 (McKinney 1996); *In re* Maijgren's Estate, 84 N.Y.S.2d 664 (1948).

21. N.Y. C.P.L.R. 4519 (McKinney 1996).

22. *Id.*

23. While an outright gift is taxed based upon its fair market value at the time of the gift, a transfer of real estate with a life use reserved is taxed based upon the fair market value less the value of the life use. The value of the life use can be determined from IRS tables that indicate a percentage (based upon age at the time of the gift) of the fair market value to be attributed to a life use. The table for calculating the percentage attributed to a life tenant can be found at Rev. Rul. 92-13, Table 5, promulgated in accordance with I.R.C. § 7520.

24. To qualify for the exemption, the co-owners must be at least 55 years of age and must use the premises as a principal residence.

25. Treas. Reg. § 1.1034-1(c)(3)(i) (1996).

26. I.R.C. § 1014.

27. The exception would be a group policy acquired by an employer for all of its employees.

28. I.R.C. § 2035.

29. *See* Regan, *supra* note 17, at 2-35.

that the contract commence with monthly payments which are intended not to exhaust the contract value, so that after death a balance will be available to the family. However, the law has changed and requires that the annuity period correspond with the life expectancy of the annuitant so that the fund and life expire at the same time.[31] An annuitized period exceeding the reasonable life expectancy of the annuitant will be considered a transfer of a resource in violation of the transfer rules. Because of this change in the law, it may be more practical to liquidate the annuity and make a partial transfer using the concept of the rule of halves.

Joint Bank Accounts

Many applicants think that the creation of a joint bank account establishes half ownership in the cotenant and that the account might not be considered to be a resource of the applicant. The law, however, has changed this presumption for Medicaid purposes.[32] The present Medicaid law presumes that a joint bank account belongs to the applicant unless the cotenant can overcome the presumption by showing that his own funds went into the account. The federal law preempts state law. Therefore, an amount determined by the rule of halves would have to be transferred out of the joint account to shelter those funds.

IRA's, 401(k) Plans, & Other Retirement Plans

Retirement plans which allow the retiree to retrieve lump sum benefits are considered a resource for Medicaid planning purposes.[33] They do not enjoy exemption from Medicaid qualifying rules.[34] This point is important because similar retirement rules in the area of bankruptcy law do enjoy protection, and many practitioners inadvertently mix those rules.[35] Accordingly, it requires as much tax planning as Medicaid planning to handle such assets.

Exemptions

In addition to the special treatment given to community spouses of applicants, there are certain other exemptions that exist.[36] Attorneys need to determine if their jurisdictions allow them. In New York, for example, a home can be transferred to a minor (under eighteen years of age) or a disabled adult child;[37] to a child who has resided in the home and cared for the applicant for two or more years; or to a brother or sister of the applicant with an equity interest in the house and who has resided there for more than one year.[38]

Many jurisdictions are adopting laws that permit the creation of special needs trusts.[39] When these trusts are funded by the applicant, the funds are allowed to remain in the trust for the applicant, provided that the remainder interest of the trust passes to the department of social services upon the death of the trust beneficiary. This can be extremely helpful to the victim of an injury with a substantial court award. Many negligence attorneys are seeking the assistance of elder law attorneys to work toward this end.

When the trust is funded by resources other than those of the applicant, the remainder of the trust may pass, upon the death of the beneficiary, to other persons designated by the settlor or grantor of the trust. This is a device now available to parents with severely disabled children who would otherwise disinherit those children so that government assistance is not interrupted. When a special needs trust is not self-funded, there is no limitation on the amount of assets that can fund such a trust.

The Burial Fund Scam Eliminated

Historically, Medicaid rules have permitted prepayment of certain funeral expenses by applicants.[40] The amount spent on those expenses was unlimited. Many applicants took advantage of this loophole by over-funding those expenses with the understanding that the undertaker would charge less than anticipated for the actual funeral and would remit the overage back to surviving family members.

---

30. 42 U.S.C. § 1396p (1996).

31. *HCFA Transmittal No. 64*, amending STATE MEDICAID MANUAL § 3258.9(B)(Nov. 1994).

32. 42 U.S.C. § 1396p(c)(3).

33. *Id.* § 1396p(e); *HCFA Transmittal No 64*, amending STATE MEDICAID MANUAL § 3257(B)(3)(Nov. 1994).

34. 42 U.S.C. § 1396p(e).

35. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974); Patterson v. Shumate, 504 U.S. 753 (1992).

36. 42 U.S.C. § 1396p(c)(2).

37. *Id.* § 1396p(c)(2)(A).

38. N.Y. COMP. CODES R. & REGS. tit. 18, § 360-4.4(c)(ii) (1996).

39. *See, e.g.*, N.Y. EST. POWERS & TRUSTS LAW § 7-1.12 (McKinney 1996).

40. 42 U.S.C. §§ 1382b, 1396p; 20 C.F.R. § 416.1231 (1997).

Beginning on 1 January 1997, undertakers will be required to set up a burial account for a Medicaid applicant as an irrevocable trust where any residue is paid to social services.[41] Though anyone can prepay a funeral without the trust arrangement, once the owner of the funeral funds becomes an applicant for Medicaid, the requirement to set up a trust kicks in; it requires any existing burial fund to be transferred into an irrevocable trust, with any remainder going to social services, in order to qualify for Medicaid.

Criminalization

Effective 1 January 1997, federal law provides criminal penalties for whoever "knowingly and willfully disposes of assets (including by any transfer in trust) in order for an individual to become eligible for medical assistance under a state plan under Title XIX, if disposing of the assets results in the imposition of a period of ineligibility for such assistance" under the transfer rules.[42] Further, 18 U.S.C. § 2 imposes criminal penalties on an attorney who "aides, abets, counsels, commands, induces, or procures" another person to commit an offense. Penalties can include a fine up to $10,000 or one year imprisonment or both.

The legislative intent of the statute was to make criminal behavior such as the passing of bearer bonds or cash among relatives without disclosing those assets upon applying for Medicaid.[43] The language of the statute, however, appears broader than its intent and will, no doubt, require a test case to determine whether it is too vague or broad and to test the application of other provisions which concern mens rea.

In the meantime, attorneys should carefully apply two criteria to any Medicaid application. First and foremost, applicants should make the application complete in every detail. The disclosure should include all the planning transfers. This must be done to avoid any inference of fraud or misrepresentation that might indicate that the transfers were illegal. This issue goes to mens rea. If the transfers are timed properly, the disclosure will be harmless to the claim.

Second, and very important, an attorney must compute the penalty period based on the law in his or her jurisdiction. The applicant must make sure that he does not apply for Medicaid until the time period has run out, with a buffer of a month. There are two reasons for this advice. One is that application after the penalty or ineligibility period has expired takes the matter out of the criminal definition entirely.[44] The other reason has to do with the computation of ineligibility and jumbo gifts. With a jumbo gift (i.e., a gift valued well in excess of the cost of three years worth of nursing home care), the applicant should wait out the entire three years from the date of the gift. If the applicant makes a large gift within three years of applying for Medicaid, the ineligibility period can extend indefinitely.[45] For example, if an applicant gives $1,000,000 to his son and waits three years and one month to apply for Medicaid, the transfer is not in the look-back period, and it cannot be considered in the transfer rules that determine the period of ineligibility. However, if the applicant gives the same gift and applies within three years, the applicant would be ineligible for $1,000,000 divided by $4,300 (using western New York State standards) or approximately 233 months (over nineteen years).

Planning Documents

Each client should work on an inventory to determine which assets ought to be retained or transferred. He should examine wills to make sure that bequests are not passing outright to persons in nursing home care. Attorneys should consider using special needs trusts, if permitted in their jurisdictions. For a married couple with one spouse in a nursing home, the clients should consider changing their wills to leave assets to children, and each spouse should execute a waiver of any right to elect against the will.

Attorneys should also prepare health care proxies, living wills, and powers of attorney for their clients. Attorneys must be cautious, however, about any provision in a power of attorney allowing the attorney in fact to make gifts. Bear in mind that a provision in a power of attorney to make unlimited gifts will be construed as a power of appointment in the event of the death of the attorney in fact. That event would require that the assets of the principal be included in the estate of the attorney in fact. Again, the applicant must be prepared to file gift tax returns should the applicant's gifts exceed $10,000 per person per year.

Conclusion

When entering this realm of legal advice, an attorney must first identify his or her client and must always be conscious of the fact that family members can have conflicting motives and desires with regard to making gifts. If the client is the applicant, the attorney should make sure that the client wants to participate in the plan and will always be in a position to succeed in obtaining assistance through the Medicaid program if the plan is executed. Most of the planning techniques that exist benefit the family or friends of the Medicaid applicant and not neces-

41. 20 C.F.R. § 416.1231(b)(3)-(6).

42. 42 U.S.C. § 1320a-7b(a)(6).

43. *Id.*

44. 18 U.S.C. § 2 (1996); 42 U.S.C. § 1320a-7b(a)(6).

45. 42 U.S.C. § 1396p(c)(1)(E)(i).

sarily the applicant, who must give up control of wealth to execute most plans.

Finally, there is a dramatic change going on in the construction of new nursing home facilities. The new facilities are not only fresher, cleaner, and nicer smelling, but there are new efforts to separate resident populations more sensibly. There are generally two categories of people who inhabit nursing homes: those who are physically infirm but have their full mental faculties and those who are physically mobile but suffer from dementia or Alzheimer's Disease. When the populations are mixed, the dementia patients tend to wander about the facility and into and out of other patients' rooms, to the distress of the physically infirm but mentally alert patients. Many new facilities are separating these populations.

If a potential patient applies to a facility as a private pay patient, the facility receives about twenty-five percent more income than it will get from a Medicaid patient. If a client wants to go to the head of the list at the new facility or the one nearest his spouse or child, the client needs to show the ability to privately pay for several months.[46] Once in the nursing home, the patient cannot be thrown out of the nursing home for becoming Medicaid qualified.[47] He can only lose his bed by an absence from the facility (i.e., a prolonged hospital stay). Furthermore, the only difference between a private pay patient and a Medicaid patient is that the privately paying patient is entitled to a private room, while Medicaid reimbursement is limited to a double room occupancy.[48]

---

46. Patricia Nemore, *Drawbacks of Medicaid for Nursing Home Residents*, 1 ELDER L. REP. 4 (1990).

47. *Id.*

48. 42 C.F.R. § 483.70 (1997).