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Medicaid Crisis Planning Techniques: Leveraging DRA Promissory Notes, Medicaid Compliant Annuities, and CSRAs

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PERSONAL ATTENTION & PRACTICAL ADVICE

Medicaid Crisis Planning-
Advanced Asset Protection Strategies:
Annuities and Promissory Notes

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Introduction

- The cost of long-term care is a major financial burden
- The probability of needing assistance with at least two ADLs is 68% for people age 65 and over.
- The annual cost of a nursing home can average from $80,000 to $150,000.
- Many clients reach out to the elder law attorney to discuss various options to protect their assets for their spouses and for their children.

Immediate Annuities

- The Deficit Reduction Act of 2005 ("DRA") included changes and clarifications to the Medicaid treatment of annuities. From an asset preservation planning perspective, the DRA has expanded the use of immediate annuities.
- The purchase of an immediate annuity which meets all the requirements of the DRA can be used to convert an otherwise countable resource into an income stream for the community spouse or the applicant.

Is the Purchase of the Annuity a Transfer of Assets?

- The DRA imposes strict rules on the purchase of annuities. 42 U.S.C.§1396p(c)(1)(G) states that the purchase of an annuity will be treated as a transfer of assets which will result in the imposition of a penalty period UNLESS the annuity is:
- Irrevocable and non-assignable;
- Actuarially sound; and
- Provides for equal payments during the term of the annuity with no balloon or deferral payments.

Non-Qualified Annuities

- 42 U.S.C.§1396p(c)(1)(F) states that a purchase of a non-qualified annuity on or after February 8, 2006 is a transfer of assets for less than fair market value, UNLESS, the State is named as the remainder beneficiary in the first position for the total amount of medical assistance paid on behalf of the institutionalized individual.
- The State can be named in second place after a community spouse, disabled child or child under the age of 21.

- The federal Centers for Medicare and Medicaid Services (“CMS”) further define a “purchase” to include any action taken by the individual that changes the course of payments to be made by the annuity.
- This includes additions of principal, elective withdrawals, requests to change the distribution of the annuity including elections to annuitize the contract. This section is applied to both applicants and community spouses.

Is the Annuity an Available Asset?

- This question became a contested issue early on in many states, as the DRA was silent on this question. Many States' Medicaid departments argued that the immediate annuity was a resource because it could be sold on a secondary market.
- *James v. Richman*, 547 F.3d 214 (3d Cir. 2008)
- The Court looked to the SSI regulations for guidance. 20 C.F.R. §416.1201(a)(1) provides that "if an individual has the right, authority or power to liquidate the property… it is considered a[n] (available) resource."

- Furthermore, with reference to the applicable POMS SI 01110.115, the Court found that since the anti-assignment language of the annuity prohibited the community spouse from transferring ownership without breaching the contract terms, the annuity could not be considered an available resource.
- Some states argued that the income stream was assignable, and therefore, could be sold to a third party; thus making the entire annuity an available asset.

- In October 2012, in *Lopes v. Department of Social Services,* 696 F.3d 180 (2d Cir. 2012), the Second Circuit Court of Appeals determined that Connecticut DSS could not count the income stream from a non-assignable, irrevocable immediate annuity as an available resource.
- The annuity had an “Assignment Limitation Rider” which provided that the contract was not transferrable; the rights in the contract could not be transferred, assigned, sold, or cashed in. The rider also stated that any attempt to transfer or assign the contract shall be void of any legal effect and shall be unenforceable against the insurance company.

- The Court relied on the SSI regulations 20 C.F.R.§416.1201(a)(1) stating that the language of the Assignment of Limitation Rider strips Lopes of the right to assign her payments under the annuity and was sufficient under Connecticut law to make the annuity non-assignable.
- In addition to the regulations and the POMS guidelines, the Court cited *James*, in rejecting DSS' argument that the income stream could be sold. The Court also relied on the recommendations given by HHS in its amicus brief.

Practice Tip

- The annuity must meet the follow requirements:
- An immediate annuity, and the contract must be irrevocable and non-assignable.
- Should be paid out in equal installments and no balloon payments.
- The terms of the contract must not exceed the life expectancy of the owner based upon the Social Security tables.
- The State must be named as beneficiary to the extent of medical assistance paid. Or named second to spouse, minor child or a disabled child.
- The annuity must be disclosed to the state Medicaid agency.
- The Community Spouse should purchase the immediate annuity *after* DOI (Date of Institutionalization) has been established and any spend down purchases have been paid.

Example

- H and W have combined assets of $300,000. H is institutionalized and the W is allowed to keep $128,640 in asset.
- Thirty days after institutionalization, W, who is 70 years old, purchases a DRA compliant annuity for $170,000, with a payout over a 5 year term. H is Medicaid eligible the following month.
- In this example a 5-year payout even though the W's life expectancy is 16 years.
- May want to accelerate the payout, hoping the W outlives the term. Remember, the community spouse's assets are not counted after Medicaid eligibility. So W could accumulate assets after eligibility.

Additional Cases

- The use of annuities in Medicaid planning has been highly contested by the states since the enactment of the DRA in early 2006.
- In 2012, the 10th Circuit Court of Appeals approved the use of annuities in Morris v. Oklahoma Dep't of Human Svcs., 685 F.3d 925 (10th Cir. 2012).
- In 2013, the US District Court for the Eighth District gave a favorable decision in Geston v. Anderson.
- In October 2013, the 6th Circuit Court of Appeals proffered a favorable decision permitting the transfer of funds from the institutional spouse to the community spouse, above the CSPA, to fund the Medicaid compliant annuity. Hughes v. McCarthy, 734 F.3d 473 (6th Cir. 2013).

Zahner Case

- One of the more recent cases on annuities, Zahner v. Secretary Pennsylvania Department of Human Services, 803 F.3d 497 (3rd Cir. 2015), was decided in September 2015. The US Court of Appeals for the Third District looked at short-term annuities in the Medicaid context.
- The Pennsylvania District Court ruled that short-term annuities (12 and 14 months) were sham transactions. The Pennsylvania Department of Human Services (DHS) defined an annuity as an investment that must return the original investment plus interest. When the contracts in question were purchased, the broker's commission was deducted. Because of the low interest rates and the short term of the contracts, the contracts actually lost money.

- Thus according to the DHS, the annuities did not meet the definition. DHS concluded that the contract were not annuities, but were rather "sham transactions intended only to shield resources from Medicaid calculations."
- The US Court of Appeals overturned the denial of Medicaid. The Court held that Transmittal 64 did not impose a minimum on the term of the annuity.

Immediate Annuity Purchased by the Applicant

- A strategic option, especially if the applicant is not expected to live long.
- Although the annuity must payout immediately and the income stream generally goes to the nursing home, the principal is still intact. In this type of case, you want the longest term possible, so the monthly payments to the home are smaller. Upon the applicant death, the spouse can be the beneficiary of the balance of the annuity.
- In Cook v. Bottesch (Ga. Ct. App. March 26, 2013), the court interpreted the DRA language as not requiring that the state be named as beneficiary on the annuity held by the Medicaid applicant. Please review your state's interpretation.

Using Qualified Funds

- With respect to annuities purchased with qualified funds, the annuity does not need to be actuarial sound. Thus the payout can be for the life of the annuitant using the RMD tables. This is useful to minimize the tax implications on the monthly payments.
- There has been some debate as to whether or not the requirement that the state be named as primary beneficiary applies to qualified funds. See *Cook,* above. Query, does the state need to be named as primary beneficiary in your state?
- If the state must be the primary beneficiary, then the longer term is risky. Please note, not all states consider qualified funds as an asset.
- In many states, if the owner is receiving RMD, then the income is counted but the principal of the account is not counted as an available asset.

Practice Tip

- When deciding whether or not a DRA compliant annuity is the proper choice for a client, consider these factors:
- 1) Can the over-assets be used for the benefit of the community spouse, such as home improvements, a new car, or pay down debt.
- 2) The age and health of the community spouse. Remember, the state is the primary beneficiary of the annuity if the community spouse dies before the end of the term.
- 3) Does the community spouse need additional income? In most cases, the income from the institutional spouse will go to the nursing home. So planning to increase the income of the community spouse may be a real goal.

Practice Tip con’t

- 4) Does the community spouse have a large retirement account? To liquidate the qualified asset would impose an income tax liability.
- 5) Is increasing the CSPA through a fair hearing an alternative option?

The Use of Promissory Notes

42 U.S.C.§1396p(c)(1)(I), provides that the funds used to purchase a promissory note, loan or mortgage on or after February 8, 2006 will be treated as an uncompensated transfer of assets unless it satisfies the following criteria:

- 1) The repayment term is actuarially sound;
- 2) The payments are made in equal amounts during the term of the loan, with no deferral and no balloon payments made; and
- 3) There can be no cancellation of the balance upon the death of the applicant/recipient.

In order for the promissory note not to be counted as an available asset, the note must be non-negotiable, non-assignable and otherwise non-transferrable.

- Promissory notes can be more flexible than annuities and can be created between family members.
- Promissory notes can also be for a very short period of time. Some states have upheld promissory notes that were for 2 months.
- Also the DRA does not require the State to be named as beneficiary.
- However, if the Medicaid recipient passes away before the end of the term, the balance of the note may be subject to Medicaid recovery.
- Promissory note planning is a common tool in many states.

Cases on Promissory Notes

- In Lemmons v. Lake (U.S. Dist. Ct., W.D. Okla, March 21, 2013) the court addressed whether or not the promissory note was an available resource.
- The court deferred to the POMS provision defining a promissory note as a resource if it is "negotiable".
- Since the note in this case had a non-transferable clause, it was not negotiable and therefore not a resource.

- The court then addressed the state’s claim that the note in exchange for property was “worthless” and therefore the transfer created a penalty period.
- The court applied the transfer rules under the DRA, finding the note had an actuarially sound repayment term; provides for equal payments and prohibits cancellation.
- The court added that the use of promissory notes as a “valid form of Medicaid planning.”

Practice Tip

- When drafting a promissory note, make sure:
- 1) The payout period is actuarially sound.
- 2) The monthly payments are equal during the term with no balloon payments.
- 3) The note is not cancelled upon death.
- 4) The note is non-transferable and non-assignable.
- 5) There is an interest rate on the note.
- 6) To keep the note simple.

Planning with a Promissory Note

- Used in combination with a gifting strategy.
- The transfer of assets (for no value) made by a Medicaid applicant will generally trigger a period of ineligibility for Medicaid benefits. This penalty period is calculated by dividing the value of the gift by the average cost of nursing home care in the region where the facility is located.
- Section 1396p(c)(1)(D)(ii) of the DRA states that the penalty period starts when the applicant is “otherwise Medicaid eligible.” This means the applicant is resource and income eligible, is receiving long-term care services (nursing home or home care in some states), and a Medicaid application is filed. At this point the penalty period begins..

- The problem is how the nursing home going to get paid during the penalty period. Well, that's where the promissory note comes in.
- The monthly promissory note payments are structured to cover most <u>but not all</u> of the cost of care during the penalty period.
- The payments are made to the applicant as the "payee" under the promissory note from the "maker", the person to whom the applicant loaned the funds, pursuant to a DRA compliant promissory note.

- Once the applicant is "otherwise eligible", the penalty period will start.
- The monthly promissory note payments paid by the maker coupled with the applicant's other income sources, such as pensions and Social Security, will provide an income stream from which the applicant will pay the nursing home during the penalty period.
- The total gross income must total less than the private pay rate of the nursing home in order for there to be a need for Medicaid. The shortfall amount should not be paid to the nursing home until the Medicaid application has been approved by Medicaid. The shortfall will have to be covered by the maker. When the penalty period expires, a second Medicaid application or recertification is filed.

Practice Tip

- Watch out for Medicare coverage and re-hospitalizations. If Medicare is paying for the applicant's nursing home stay, he may not be "otherwise eligible" as he has no medical expenses for Medicaid to cover.
- Watch out for any LTC insurance payments in your calculations.
- Before making the promissory note/gift, remember to pay down all expenses, such as attorney's fee, funeral, and other medicals costs incurred prior to planning.
- Do the math several times. The applicant's gross monthly income plus the promissory note payment must be less than the private monthly rate at the nursing home.
- Ask about prior gifts, which may impact the amount of the present gift.

Example

- Sam enters the nursing home on January1st. Sam has $100,000 in assets. His gross income is $1600 from Social Security He just received notice that his Medicare will end on January 31st. The private pay rate at the nursing home is $12,000.
- Sam consults with a smart elder law attorney who suggests a promissory note/gift strategy. Sam gifts $50,000 to his son, Jeff, in February. This transfer creates a penalty period of 5 months based on the Medicaid divisor in the region.
- Sam then loans the other $50,000 to Jeff. The terms of the promissory note are such that the $50,000 will be paid back to Sam with interest over the next 5 months.

- Using an interest rate of 3%, this makes the payments $10,075.12.
- With his monthly income of $1600, there will be a shortage of $324.88/month. Now Sam has no funds, and is otherwise Medicaid eligible as of February 1st and he submits a Medicaid application.
- The penalty period begins and the repayment of the loan and Sam's income will go to the private pay cost of the nursing home during the penalty period.
- At the end of the penalty period, Medicaid will then start to cover the cost of care. Jeff will have to reimburse the home the deficit.

Conclusion

- DRA-compliant immediate annuities and promissory notes offer clients a few more solutions to an immediate long-term care crisis.
- On the horizon……Some states have begun to create obstacles to reduce the efficacy of these valuable planning strategies.
- The state of Connecticut had a bill pending that would require the community spouse to contribute some of the income generated from a community spouse's DRA annuity to the care of the institutionalized spouse. The state of Wisconsin has tried in the past to make promissory notes between family members voidable.

Thank you

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Medicaid Crisis Planning: Leveraging DRA Promissory Notes, Medicaid Compliant Annuities, Community Spouse Resource

Strafford Webinars

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AGING IN ALABAMA

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COMMUNITY SPOUSAL RESOURCE ALLOWANCE

INCOME AND RESOURCES

- Income below $ 2349 for applicant, some states count couples' income
- Single – Countable Resources below $2000
- Married -- Countable Resources below $257,280
- Life insurance/burial funds less than $ 1500 (or $5000) each

5(B) MAXIMIZE INCOME: MEDICARE SAVINGS PROGRAM

- QMB/SLMB/QI
- Income driven: 1061/1269/1426
- Married 1430/1711/1923
- Most states limit assets (federal limit: single: 7,730, married: 11,600)
- Several states (including AL) do not count assets

SPEND-DOWN STRATEGIES FOR MARRIED APPLICANTS

1. EXEMPT PURCHASES

- Funeral/Burial
- House
- Car
- Pay debt (mortgage, minimize debt for community spouse)
- Work on home

EXAMPLE: EXEMPT PURCHASES

- **MARRIED CLIENT IS GOING IN NURSING HOME, HAS $65,000.00.**
- **COUPLE HAS NO LIFE INSURANCE, NO FUNERAL POLICY**
- **OPTION 1: do nothing, spenddown on the nursing home, give spouse 1/2 (or may have to spenddown to $25,000), once below $2000 then client qualifies for Medicaid. When client passes away, spouse pays for funeral out of that spouse's 1/2**
- **OPTION 2: buy a prepaid policy that complies with your state's regulations, spouse gets a minimum of 25,728, spenddown on nursing home. At death, funeral is paid from policy. THIS IS BETTER.**

2. EXEMPT TRANSFERS

- To spouse (but if spouse is sick…)
- To disabled child (everything)
- To caretaker child (house)
- To sibling with an equity interest (house)
- To minor child (house)
- To special needs trust (for disabled child or self settled if under age 65)
- To special needs trust (pooled for over age 65)

EXAMPLE: EXEMPT TRANSFER

- **MARRIED CLIENT IS GOING IN NURSING HOME, HAS $50,000*.**
- **HAS NO RESOURCES FOR ITEMS SHE/HE MAY NEED**
- **OPTION 1: do nothing, give spouse 1/2*, spenddown rest on the nursing home, once below $2000 then client qualifies for Medicaid. When client needs something (lift chair, uncovered therapy, maybe private room fees (but maybe not), property taxes, insurance, cell phone, eyeglasses), spouse pays out of their $25,000.**
- **OPTION 2: give spouse 1/2, open a special needs trust for the other 1/2, you are spentdown on nursing home. The client's trust pays for uncovered needs. At death, Medicaid gets what is left. THIS IS BETTER.**
- ***Some states permit the spouse to keep up to $128,640 without spending any on the nursing home, like Florida**

3(A). COMMUNITY SPOUSE INCOME

- In most states, community spouse can keep all of his income (if over the MMMNA)
- The MMMNA (Minimum Monthly Maintenance Needs Allowance) changes each July: it is $2,113.75 per month ($2641.25 Alaska)($2,432.50 Hawaii)(minimum) $3,216.00 (maximum) $634.13 for excess shelter resource ($792.38 Alaska)($729.75 Hawaii)
- So for spouses that will need MMMNA avoid strategies that maximize income of spouse

3(B) COMMUNITY SPOUSE ASSETS

- CSRA – community spouse resource allowance – spouse may keep up to ½ of the resource amount ($128,640)
- Some states permit up to half
- Some states require s “spenddown” – must spend ½ to keep ½
- Spouses may keep a minimum of $25,728 without spenddown)

4. FANCY STUFF

- Consider resetting the snapshot date if the planning has not been done
- For example: Client has spouse who will keep home, has $40,000.00 and is admitted to nursing home. House needs work (or has mortgage). Consider having client go home with care, perform repairs (or pay mortgage), then transfer home to spouse

5 (A). ANNUITIES

- MUST BE CAUTIOUS!
- Annuity must be Medicaid compliant
- Use to maximize spousal income (particularly if already over MMMNA)
- Must be actuarially sound
- Must have Medicaid as beneficiary

5(B) INCOME ONLY TRUSTS

- Beware trust language
- Effective if done correctly
- Still subject to 5 year lookback period for planning

6. IF YOU HAVE TIME TO PLAN

- Long term care insurance
- Irrevocable Trust
- Correct problems with spending (paying for family member obligations, gifting)
- Transfer home, reserve life estate (some states may seek recovery)
- CCRC buy in

7. WHAT'S YOURS IS MINE, WHAT'S MINE IS MINE, WHAT'S OURS IS MINE

- Medicaid will count couple as one person
- Spouse at home can generate further penalties by transferring assets
- Beware the "caretaker" at home, once assets are split, Medicaid will still monitor those assets, must strictly comply with rules

PROMISSORY NOTES

- MUST BE ACTUARIALLY SOUND
- MUST HAVE CURRENT INTEREST
- MUST BOT BE FORGIVEN AT DEATH
- WILL COUBT AS INCOME
- NICE TO AVOID PENALTIES
- FIX GIFTING ERRORS
- GIOD FOR STATES THAT DO NOT PERMIT TRANSFER TO SNT