Strafford

Presenting a live 90-minute webinar with interactive Q&A

VA Benefits Rules: Determining Eligibility, Valuation of Assets, Look-Back Periods, Transfer Rules, Penalties

THURSDAY, MAY 20, 2021

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Valerie Peterson, Chief Executive Officer, **ElderCounsel**, Evergreen, Colo.

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1**.

ELDERCOUNSEL

The Use of Irrevocable Trusts in VA Pension Planning After October 18, 2018

Valerie L. Peterson, J.D.
CEO
ElderCounsel, LLC
www.eldercounsel.com

The Department of Veterans Administration (VA) has provided new eligibility rules for wartime Veterans and surviving spouses of wartime Veterans who are eligible for VA pension benefits. The rules addressed trusts by first defining them, then setting out how and when transfers to a trust would be penalized. These rules will go into effect on October 18, 2018.

A trust is "a legal instrument by which an individual (the grantor) transfers property to an individual or an entity (the trustee), who manages the property according to the terms of the trust, whether for the grantor's own benefit or for the benefit of another individual."[1] For purposes of calculating a penalty period, "uncompensated value" means the difference between the fair market value of an asset and the amount received. With regard to transfers to a trust, annuity or other financial instrument or investment, "uncompensated value" means the amount transferred.[2]

[1] 38 CFR §3.276 (a)(5)(ii)(B)
[2] 38 CFR §3.276 (a)(6) *This definition was expanded in the final rule to address trusts, annuities and other financial instruments.*

A transfer to a trust would not be penalized if the claimant/grantor retains control and the ability to liquidate for the claimant/grantor's benefit. [3] Those assets would be counted as part of a claimant's net worth, though.

The new rules also provide an exception to the trust transfer provisions. A Veteran, a Veteran's spouse, or the surviving spouse of a Veteran may transfer assets to a trust established on behalf of a child if the VA has rated the child incapable of self-support pursuant to 38 CFR §3.36 AND there is no circumstance where the trust assets can benefit the Veteran, the Veteran's spouse or the Veteran's surviving spouse.[4]

The prior provisions of 38 CFR 3.276 that defined "total relinquishment" of an asset (including the statement that a transfer to a relative residing in the home would not satisfy that definition) have been replaced by the new rules that define net worth and covered assets.[5] Net worth now includes the income and assets of the Veteran and any dependents and is subject to a limit that equals the maximum Community Spouse Resource Allowance in effect at the time the application is filed. In 2018, this number is $123,600 and increases each year.

In addition to the net worth limit, beginning 10-18-18, any "covered assets" transferred will be subject to a lookback period of 36 months, and will be subject to a penalty period.[6] The effect of the lookback and penalty period is that claimants with substantial assets will now need to plan 36 months in advance, as any transfers of covered assets will be penalized using a divisor

[3] See supplementary information provided with the final rules, https://www.federalregister.gov/documents/2018/09/18/2018-19895/net-worth-asset-transfers-and-income-exclusions-for-needs-based-benefits

[4] 38 CFR §3.276(a)(8)(d)

[5] 38 CFR §3.274(a)-(b)

[6] 38 CFR §3.276

amount that is equal to the maximum monthly pension amount for a Veteran with one dependent. In 2018 this number is $2,169.

Previously, the VA had provided little guidance in the area of trusts and how they may be used in the context of VA pension benefits planning. In fact, there are only 5 reported General Counsel's opinions the last 19 years, and only 1 since 1997. Because nothing in the new rules addressed what is contained in the opinions, we believe they will still be followed by the VA. There are also recent decisions from the Board of Veterans Appeals (BVA) that discuss how assets in an irrevocable trust will be considered for VA pension purposes. Below is a summary of the five reported General Counsel opinions, all of which can be found on the General Counsel website, https://www.va.gov/ogc/precedentopinions.asp as well as some recent decisions, which can be found on the BVA website, https://www.index.va.gov/search/va/bva.jsp.

General Counsel Opinions

In VAOGCPREC 72-90, the claimant, who was in a VA facility and was receiving pension, became the beneficiary of a testamentary trust worth $22,000. Under the terms of the trust the Trustee had sole discretion to provide funds for the veteran's comfort, but not as a substitute for support and maintenance to which the veteran was legally entitled from other sources. Once the trust was funded, the claimant's pension was stopped as his income and assets exceeded the limit then allowable.

The General Counsel's opinion recognized that the veteran held no legal title to the trust assets but only held an equitable interest as a beneficiary. The opinion concluded that only the portion of the trust property, including trust-related income, that has actually been made available for the veteran's use, is countable for purposes of determining pension eligibility.

VAOPGCPREC 64-91 dealt primarily with questions pertaining to a veteran's home and how it is counted. However, one question dealt directly with trusts, and whether a veteran who receives income as beneficiary of a private trust fund should have the entire value of the trust fund be included in his estate. The General Counsel reaffirmed its prior holding in 72-90 stating that trust assets should not be included in the veteran's estate except to the extent trust assets are allocated and are available for the veteran's use.

VAOPGCPREC 73-91 involved a veteran who was receiving pension and received an inheritance from his son in the form of life insurance proceeds. The veteran/claimant wanted to set up a trust for the benefit of his three grandchildren and no benefit coming back to him.

The opinion held that as long as the trust assets were for the benefit of the veteran's grandchildren and the veteran could not benefit from the income or principal, the trust assets would not be counted as part of his net worth for pension purposes. (As a side issue, the opinion also notes that the receipt of the life insurance proceeds would be income to the veteran that could disqualify him from pension benefits for up to a year). Unfortunately, we do not know whether the trust involved was an intentionally defective grantor trust.

The opinion in 73-91 raises the issue of whether the trust would be counted if the grandchildren resided in the veteran's home pursuant to 38 CFR §3.276(b) which applies to transfers of assets and states, "[a] gift of property to someone other than a relative residing in the grantor's household will not be recognized as reducing the corpus of the grantor's estate 'unless it is clear that the grantor has relinquished all right of ownership, including the right of control of the property." Because distributions only vest when each grandchild turns 21, the opinion held this as a future interest rather than a present interest in the trust assets, therefore 38 CFR §3.276(b) may not apply. However, the second issue to consider if the grandchildren were living in the home is whether the veteran/claimant benefitted in any way from the trust assets. The answer to this was not given as the facts did not state whether the grandchildren were in fact living with the veteran/claimant.

VAOPGCPREC 15-92 answered the question of how a life estate interest should be treated. In 15-92, the surviving spouse of a veteran held three life estate interests in property she and her husband transferred to their children the year prior while retaining the right to farm the land and collect the rents therefrom. Upon the death of her husband, she applied for death pension and was denied in part due to excessive net worth as a result of the three properties in which she held a life estate interest.

The General Counsel's opinion examined 38 C.F.R. §3.276(b) for help in determining whether a transfer occurred when a life estate was retained and a remainder interest given away. In defining what a life estate is, General Counsel also looked to C.J.S. and the American Law of Property to define the rights of a holder of a life estate, noting that a life estate holder has a duty to the remaindermen even though the holder of the life estate has exclusive use and enjoyment of the property during his/her lifetime. Accordingly, the General Counsel held that the wife had not relinquished all rights of ownership in the three properties but instead maintained complete control over the life estates in each. Therefore, all three properties were considered as part of her net worth for VA pension purposes. <u>The new rules do not address life estate interests, so it is assumed that the current rules will continue to apply</u> and the full value of the property will be counted.

The final reported opinion concerning an irrevocable trust is perhaps the most damaging one. VAOPGCPREC 33-97 considered whether the assets held in a self-settled special needs trust should be counted as either income or net worth (or both) for purposes of pension. Unfortunately, the answer came back as "yes."

In 33-97, an "Irrevocable Living Trust" was established for the surviving spouse of a veteran. A child of the surviving spouse was named as trustee. The trust stated that some or all of the income and principal of the trust fund may be paid by the trustee to or for the benefit of the surviving spouse for the surviving spouse's "special needs for health, safety and well being when such requisites are not presently being provided by any public entity, office or department of the beneficiary's state of residence, or of any other state, or of the United States."

Other pertinent terms of the trust included the following:

> "Special needs" shall include, but not be limited to, medical and dental expenses; equipment; programs of training, education and treatment. Trustee shall have no discretion in Trustee's distribution of income and principal for special needs . . . . The express purpose of this trust shall be to provide for beneficiary's extra and supplemental needs for health, safety and well being in addition to and over and above the benefits provided by any public entity, office or department of the beneficiary's state of residence . . . or of the United States. It is the express purpose of the Trustor to use this trust estate only to supplement other benefits . . . .
>
> Distributions to beneficiary . . . are to be considered as from a discretionary, and not a basic support, trust, and the beneficiary's trust interest shall not be used to provide basic food, clothing and shelter, nor be available to the beneficiary for conversion for such items, unless all governmental and nongovernmental benefits for which the beneficiary is eligible as the result of disability or handicap have first been fully expended for such purposes.

Id.

The opinion first attempted to analogize the special needs trust 15-92 with the special needs trust established in 33-97 noting, "The trust document at issue here establishes a so-called 'living trust,' an arrangement somewhat analogous to a life estate." While comparing the two, General Counsel opined that although the spouse here did not have the mental faculties to exercise control over the trust property, "the surviving spouse could be considered as exercising control over the trust assets if the surviving spouse gave the trustee control over the assets while the surviving spouse retained sufficient mental faculties and provided specific instructions concerning the circumstances under which trust assets would be used for the surviving spouse's benefit, or if someone lawfully empowered to act on her behalf established the trust. In this manner, the surviving spouse could be considered to exercise 'control' over the trust assets even though the surviving spouse is now completely incapacitated."

In painstaking fashion, General Counsel went on to explain that the literal terms of the trust make the trust assets available for the spouse's support. While the opinion noted the express terms of the trust which state that no part of income or principal shall be considered available for purposes of determining eligibility for government benefits, "such a unilateral declaration has no legal effect with respect to VA's determination of entitlement to benefits, which is governed by Federal law."

Although the reasoning in 33-97 lacked a certain legal soundness, it appears that a self-settled special needs trust is not a viable planning tool for VA pension purposes. Transfers to a pooled trust would probably be evaluated in much the same way, and should be avoided if VA pension is desired.

Recent Board of Veterans Appeals (BVA) Decisions

In Docket No 16-02 867 decided Feb. 16, 2017[7] the claimant transferred approximately $100,000 to an irrevocable trust in 2014, prior to applying for VA pension benefits. (An annuity was also purchased but will not be discussed here.) The opinion states that the irrevocable trust was "established in the name of his son." The son was the trustee, and the Veteran was an income beneficiary. According to the terms of the trust the Veteran had no ownership or rights to

[7] Opinion may be found here: https://www.va.gov/vetapp17/files1/1704793.txt

principal and the trustee had no authority to distribute principal to the Veteran. However, the trust stated that the trustee is "required to maintain the trust for the benefit of the lifetime beneficiaries." The Veteran was the only income beneficiary named in the trust.

In the opinion, the Board notes that based on the M21-1MR provisions and prior General Counsel opinions, the VA should include trust assets in net worth calculations if those assets are available for use for the claimant's support. If the Veteran is receiving a benefit from trust expenditures, then a determination must be made to determine whether the Veteran is exercising such control and use of trust assets that they are available to the Veteran.

Because the income was available to the Veteran and the trustee was required to maintain the trust for the benefit of the lifetime beneficiaries (including the Veteran), then the Board found that the Veteran's "income beneficiary interest in the irrevocable trust estate" is countable for net worth purposes. The Board included the entire value of the trust assets for net worth purposes.

A nearly identical result was reached in Docket No. 13-17 549, decided June 15, 2017.[8] There, the Veteran and his spouse transferred approximately $115,000 to an irrevocable trust prior to applying for VA pension benefits. The Veteran and his spouse were the only income beneficiaries and their son was trustee. The trust stated that the trustee's duty was to maintain the trust fund for the benefit of the trust and the beneficiaries. In 2013, the trustee paid the Veteran and his spouse $19,000 from the trust to help with medical expenses.

Quoting prior General Counsel opinions that reviewed under what circumstances trust assets should be counted, the Board noted that trust assets would *not* be countable unless (1) it is actually owned by the claimant; (2) the claimant possesses such control over the property that the claimant may direct it to be used for the claimant's benefit; or (3) funds have actually been

---

[8] https://www.va.gov/vetapp17/files1/1704793.txt

allocated for the claimant's use. The VA may also make a case by case determination if a Veteran is receiving benefit from the trust.

The Board held that trust assets were countable as part of net worth because the Veteran and the spouse were income beneficiaries, the trustee was required to maintain the trust for the benefit of the beneficiaries, and the Veteran and his spouse benefited from trust assets when $19,000 was paid to them in 2013.

Contrast the above with a favorable BVA opinion that involved an irrevocable trust, Docket No. 15-23 806, decided March 6, 2017.[9] In this case, the Veteran's surviving spouse was receiving death pension. Her benefits were discontinued after her home, which was held in an irrevocable trust, was sold.

The irrevocable trust was established in 2010, at which time the home was transferred into the trust. Neither the surviving spouse nor the Veteran (alive at the time) were income or principal beneficiaries of the trust. The trust stated that the Veteran and surviving spouse, "shall have no right or ownership or benefit to the principal or interest of the Trust property." The beneficiaries were the appellant's children and their descendants. Interestingly, the trust allowed the trustee to make gifts to the lifetime beneficiaries for charitable or religious purposes, or for the maintenance or health needs of the appellant.

When the home was sold in 2014, the surviving spouse was receiving death pension. Those benefits were discontinued with the VA finding that the home proceeds were part of her net worth. The BVA sided with the surviving spouse, finding that the irrevocable trust only lists her children as beneficiaries, and any gifts given to the spouse from trust assets (as had happened in the past) were not shown to be regular period payments exclusively allocated for her actual

---

[9] https://www.va.gov/vetapp17/files2/1706739.txt

use. The Board further found that the appellant had no control over the trust assets nor any property interest in the trust, therefore it was unreasonable to believe that the house proceeds would be used for the spouse's maintenance. Her death pension benefits were reinstated.

A similar result was reached in Docket No. 15-31 061, decided September 4, 2018, https://www.va.gov/vetapp18/files9/18131466.txt. A claimant transferred assets to an irrevocable trust prior to applying for pension benefits. The claimant had no access to principal or income, and the Court found that the trust assets were not countable for VA pension purposes.

Where does that leave irrevocable trusts for VA purposes?

The use of an irrevocable trust for VA pension purposes is a viable planning strategy, especially now that many Veterans or surviving spouses will need to engage in proactive planning – meaning they must plan in advance and wait out the 36-month lookback period. The irrevocable trust described below can also work for Medicaid planning purposes, meaning you don't have to guess which benefit will be access first in the future.

The use of an intentionally defective grantor trust (also referred to as a Medicaid Asset Protection Trust™) may be used as long as it is clear that the grantor has no right to income at all. It is also advisable to only place non-income producing assets in this type of trust as the VA has access to a claimant's tax returns. If income in this type of irrevocable trust is reported as belonging to the grantor, the VA could question whether the claimant has given up complete control of the property, and whether the claimant is benefitting from trust income or principal. In the author's opinion, it is safer not to place assets (other than a home as described below) into an intentionally defective grantor trust if the purpose is to qualify for Aid and Attendance.

A common use of this type of trust in the VA context is for the claimant's home as the 121 exemption may be preserved for the home, and capital gains will be taxed according to the grantor's individual capital gains rate. Under the new rules, the transfer of the home will not be penalized as it is not a "covered asset." It is advisable to draft the trust to require distribution of the proceeds to the lifetime beneficiaries immediately upon the sale of the home to avoid any income being reported on the grantor's tax return in the event the proceeds are left in the trust.

To protect the 121 Exemption and any local homestead exemptions, you will want to include special retained rights in the home, as well as a special power of appointment to change beneficiaries at the grantor's death. This will preserve the step-up in basis at death. Make sure, however, that your power of appointment is exercisable by will only and that the language does not give the grantor the power to appoint accumulated income as this will confer grantor trust status over trust income – a result we are trying to avoid.

Be sure your trust states that when the home is sold the trust will terminate and the assets will be paid out to the lifetime beneficiaries, or to another irrevocable trust that is not defective.

A nongrantor irrevocable trust may also be used for VA pension purposes, again where the grantor has no access to income or principal. We suggest mandatory payment of income to the lifetime beneficiaries to avoid any grantor trust "traps." The income is taxable income to the income beneficiaries. However, if they are also beneficiaries of principal, the income beneficiaries can take a distribution from the trust to cover their increased tax liability.

With this type of trust, there is very little risk of the VA questioning whether the veteran has relinquished all control of the trust assets or is benefitting at all from trust income or principal. Furthermore, by reserving a limited testamentary power of appointment to change beneficiaries, the trust assets will receive a step up in basis at the death of the grantor.

You also want to make sure payment of income is mandatory, but not payment of principal.

An irrevocable third-party supplemental needs trust may also serve as a valuable planning tool for VA pension purposes. If the claimant is the grantor, it must be irrevocable, again so there is no argument by the VA that the claimant/grantor has not relinquished control of the assets placed into the trust. An irrevocable sole benefit trust would also appear to work in the context of VA pension planning. Just remember that transfers to any irrevocable trust, other than one established for the benefit of a child incapable of self-support prior to age 18, will be subject to the lookback and penalty period after October 18, 2018.

Drafting tip: In ElderDocx you can use the Third-Party Supplemental Needs Trust document group or the Sole Benefit Trust Document group. While the Third-Party Supplemental Needs Trust may be revocable or irrevocable, for VA purposes you should choose irrevocable. The distribution standard choices will be supplemental and discretionary or just discretionary. If Medicaid may be an issue for the beneficiary in the future, it is important to check your state's rules to determine whether a purely discretionary trust will count against the beneficiary for Medicaid purposes.

The Veterans Asset Protection Trust®

ElderCounsel has taken the characteristics of each intentionally defective trust and nongrantor trust described above and combined them into one trust, the Veterans Asset Protection Trust® (VAPT®). While divided into a subtrust for the principal residence (that is treated as an IDGT) and a subtrust for all other assets (treated as a nongrantor trust), the VAPT allows for more efficient administration of trust assets and ensures that no mistake can be made during funding or upon the sale of the principal residence. Clear instructions are provided to the trustee to protect the 121 exclusion, how to handle proceeds upon sale of the grantor's home, how to allocate capital gains on the home, and a restriction upon renting the principal residence is in place.

Furthermore, decanting provisions are built in to allow for changed circumstances that may require a change in the structure of one of the subtrusts, or a change in how the subtrust is funded. Great care was taken to ensure the correct trustee options were chosen in the interview to allow decanting in the future if needed.

Conclusion

Irrevocable trusts will play an even bigger role in Veterans pension planning with the new lookback and penalty period rules in place. Attorneys in this area must use great caution when drafting any type of irrevocable trust to avoid having assets counted due to income being available to the grantor, or the grantor retaining control over trust assets.

CHANGES TO THE VA PENSION RULES

Effective October 18, 2018

Prepared by:
Valerie L. Peterson, J.D.
CEO, ElderCounsel LLC

Changes to the VA Pension Rules Effective October 18, 2018

Prepared by:

Valerie L. Peterson, J.D.
CEO, ElderCounsel LLC

Style note: The word "Veteran" is capitalized throughout, regardless of whether it is capitalized in the rules.

Introduction

On January 23, 2015, the Department of Veterans Affairs (VA) published a comprehensive set of rules that would amend 38 CFR Part 3. Part 3 covers net worth, asset transfers and income exclusions for needs-based benefits. The stated purpose of the proposed change was to "maintain the integrity of the pension program and to implement recent statutory changes" and to "respond to recent recommendations made by the Government Accountability Office (GAO), to maintain the integrity of VA's needs-based benefit programs, and to clarify and address issues necessary for the consistent adjudication of pension and parents' dependency and indemnity compensation claims."[1]

On September 18, 2018, the VA published its final rules. While retaining the lookback and penalty period, the final rules addressed some inconsistencies and some unfair provisions contained in the original proposed rules.

The final rules

[1] Federal Register RIN2900-A073, Summary.

The stated purpose of the final rules remained the same: "maintain the integrity of the pension program and to implement recent statutory changes" and to "respond to recent recommendations made by the Government Accountability Office (GAO), to maintain the integrity of VA's needs-based benefit programs, and to clarify and address issues necessary for the consistent adjudication of pension and parents' dependency and indemnity compensation claims."

The changes are quite comprehensive and touch on a number of areas including net worth, asset transfers, medical expenses and income deductions. This paper will focus on those areas affecting eligibility for pension programs.

Net worth

Proposed rule 38 CFR §3.274(a) and (b) would impose a limit on net worth equal to the maximum community spouse resource allowance for Medicaid purposes on the effective date of the final rule.[2] In 2018 this number is $123,600. This amount would increase by the same percentage as the cost-of-living increase for Social Security benefits. The current net worth limits can be found on the VA website, www.benefits.va.gov/pension/. Net worth is defined as "the sum of a claimant's or beneficiary's assets and annual income."[3]

As noted in the definition of net worth, annual income is added to a claimant's assets to come up with a total net worth number. The example provided in 3.275(b)(4) states, "For purposes of this example, presume the net worth limit is $123,600. The claimant's assets total $117,000 and annual income is $9,000.

---

[2] Federal Register RIN2900-A073, 38 CFR §3.274(a)
[3] 38 CFR §3.274(b)(1)

Therefore, adding the claimant's annual income to assets produces net worth of $126,000. This amount exceeds the net worth limit."

A Veteran's assets are defined to include the assets of the Veteran as well as the assets of his or her spouse. [4] A surviving spouse's assets only include the assets of the surviving spouse.[5] The VA will not consider a child to be a dependent child of the Veteran or surviving spouse if the child's net worth exceeds the net worth limit. [6] A child whose net worth exceeds the limit is referred to as a "potential dependent child."[7] A "dependent child" is a one for whom a Veteran or surviving spouse is entitled to an increased maximum annual pension rate.[8] However a dependent child's net worth consists of the child's income and assets, along with the income of the Veteran or surviving spouse.[9]

When net worth is calculated

The VA will calculate a claimant's net income as of the date of: the original pension claim; at the date of a new pension claim after a period of non-entitlement; upon a request to establish a new dependent; or after receiving information that a claimant's net worth has changed.[10]

Decreasing net worth

There are three ways net worth may be decreased: the assets decrease; annual income decreases; or both decrease. Assets decrease when a Veteran,

[4] 38 CFR §3.274(c)(1)
[5] 38 CFR §3.274(c)(2)
[6] 38 CFR §3.274(d)
[7] 38 CFR §3.274(d)(1)(ii)
[8] 38 CFR §3.274(d)(1)(i)
[9] 38 CFR §3.274(d)(2)-(4)
[10] 38 CFR §3.274(e)

surviving spouse, child or someone acting on their behalf spends their assets on "any item or items purchase for which fair market value is received" unless the items purchased are part of their net worth. [11]

If there are allowable exclusions to income, the VA will apply those first to decrease annual income. If there are additional expenses that are appropriate to deduct from income, then those expenses may be used to reduce the assets.

Example from 3.274(f)(1)(3): Net worth limit is $123,600. MAPR is $12,000. Claimant's assets total $115,000, and annual income is $9,000. Total net worth: $124,000. However, the claimant is a patient in a nursing home and pays out of pocket fees of $29,000 per year. Claimant's unreimbursed medical expenses total $29,000, which exceeds the 5% deductible of the MAPR, or $600. The projected expenditures that exceed 5% of the MAPT (here, $28,400) are deducted from annual income, which is now zero. The claimant's net worth is now $115,000 as there is no countable income to add to it.[12]

Effective dates of pension entitlement following a denial or reduction based on excessive net worth

The effective date of pension entitlement is the day net worth ceases to exceed the limit, provided the claimant submits a certified statement that net worth has decreased, and the VA has received the statement within 1 year after its decision notice (unless an appeal was made). [13]

---

[11] 38 CFR §3.274(f)(1) *This is a change from the proposed rule which allowed a decrease only for payment of basic living expenses like food, shelter, clothing or health care, or on education or vocational rehabilitation.*
[12] 38 CFR §3.274(f)(3)
[13] 38 CFR §3.274(g)(2)

<u>Effective date for a denial, reduction or discontinuance due to excessive net worth</u>

The effective date of entitlement or increased entitlement is the day net worth is no longer excessive.[14] To get this effective date, the claimant has to provide a certified statement that net worth has decreased and the VA must receive it before the claim has been finally adjudicated. Otherwise the effective date is the date a new pension claim is received by the VA.

When an increase in a beneficiary's net worth results in a reduction or discontinuance of benefits, the effective date of the reduction or discontinuance is the last day of the calendar year in which net worth exceeds the limit. [15] If net worth decreases below the limit before the end of the calendar year, pension benefits will not be reduced or discontinued on the basis of excessive net worth. [16]

There are additional rules that pertain to reduction based on a dependent child's excessive net worth that are not discussed in detail here but can be found at 38 CFR §3.274(h)(2)(i)(2).

<u>Determining the asset amount for pension net worth</u>

38 CFR §3.275 contains a number of modified or new definitions. Subsection (a) contains a new definition for the term "assets." Assets are defined as "fair market value of all property than an individual owns, including all real and personal property, unless excluded under paragraph (b) of this section, less the amount of mortgages or other encumbrances specific to the mortgaged or encumbered

[14] 38 CFR §3.274(g)(2)
[15] 38 CFR §3.274(h)(1)
[16] 38 CFR §3.274(h)(2)

property. VA will consider the terms of the recorded deed or other evidence of title to be proof of ownership of a particular asset."

New definition for "residential lot area"

The residential lot area under the proposed rules would not exceed 2 acres unless the additional acreage is not marketable. [17]

Exclusions from the definition of "assets"

The primary residence remains excluded from the definition of assets, and if sold, the proceeds will not count if used to purchase another residence within the same calendar year as the sale.[18] If the claimant is not residing in the personal residence it will still be excluded.[19] Personal mortgages on the primary residence will not reduce the value of any assets. [20] If the residential lot area exceeds 2 acres, then the value of the additional land above the 2 acres is included in the asset calculation.

Personal effects "suitable to and consistent with a reasonable mode of life" will be excluded from the total asset value. [21] The rule notes appliances and family transportation vehicles as examples.

Other exclusions include Radian Exposure Compensation Act payments, Ricky Ray Hemophilia Relief Fund payments, Energy Employees Occupational

---

[17] 38 CFR §3.275(a)(3)
[18] 38 CFR §3.275(b)(1)
[19] 38 CFR §3.275(b)(ii)
[20] 38 CFR §3.275(b)(1)(i)
[21] 38 CFR §3.275(b)(2).

Illness Compensation Program payments, payments to Aleuts and other items listed in 38 CFR §3.279. [22]

Asset Transfers and Penalty Periods

38 CFR §3.276 discusses the new transfer rules and penalty periods that will be imposed for transfers made prior to applying for VA pension.

Assets subject to a transfer penalty

Only those "covered assets" that are transferred will be subject to a penalty period. A "covered asset" is defined as an asset that "was part of the claimant's net worth, was transferred for less than fair market value, and if not transferred, would have caused or partially caused the claimant's net worth to exceed the net worth limit…"[23] Therefore, only the amount transferred in excess of the net worth provisions will be subject to a penalty.

Example in 38 CFR §3.276(a)(3)(i): The net worth limit is $123,600. A claimant has total assets of $115,900 and his annual income is zero. The claimant, prior to applying for benefits, gave $30,000 to a friend. Had the claimant not previously transferred the $30,000, his net worth would have been $145,900 and his assets would have exceeded the net worth limits. The "covered asset" amount is $22,300 (the amount subject to a penalty) as this represents that amount by which the claimant's net worth would have exceeded the limit due to the covered asset.[24]

Fair market value is defined as the price a willing buyer would pay and a willing seller would sell for. The VA will use "best available information" to

---

[22] 38 CFR §3.275(b)(4)-(7)
[23] 38 CFR §3.276(a)(2)
[24] 38 CFR §3.276(a)(3)(i)

determine fair market value, including appraisals, public records, inspections and market value of similar property if applicable.[25]

A transfer for less than fair market value includes the sale, gift or exchange of an asset for less than fair market value, or the transfer or purchase of any financial instrument that reduces net worth and "would not be in the claimant's financial interest but for the claimant's attempt to qualify for VA pension," including the purchase of an annuity.[26]

An annuity is defined as "a financial instrument that provides income over a defined period of time for an initial payment of principal."[27] A trust is "a legal instrument by which an individual (the grantor) transfers property to an individual or an entity (the trustee), who manages the property according to the terms of the trust, whether for the grantor's own benefit or for the benefit of another individual."[28] For purposes of calculating a penalty period, "uncompensated value" means the difference between the fair market value of an asset and the amount received. With regard to transfers to a trust, annuity or other financial instrument or investment, "uncompensated value" means the amount transferred.[29] **This means any asset that is converted into an annuity will incur a transfer penalty.**

Lookback period

[25] 38 CFR §3.276(a)(4)
[26] 38 CFR §3.276 (a)(5)
[27] 38 CFR §3.276 (a)(5)(ii)(A) *Specific reference to a trust was included here in the original rules. In the final rules it was removed and the definition of trust was kept as a separate definition.*
[28] 38 CFR §3.276 (a)(5)(ii)(B)
[29] 38 CFR §3.276 (a)(6) *This definition was expanded in the final rule to address trusts, annuities and other financial instruments.*

The lookback period for all transfers is 36 months immediately preceding the date the VA receives an original pension claim or a new pension claim after a period of non-entitlement.[30] **This definition does not include any transfers prior to October 18, 2018.**

General statement of policy

38 CFR §3.276(a)(8)(b) provides a statement on the VA's policy about transferring covered assets. "VA pension is a needs-based benefit and is not intended to preserve the estates of individuals who have the means to support themselves. Accordingly, a claimant may not create pension entitlement by transferring covered assets. VA will review the terms and conditions of asset transfers made during the 36-month lookback period to determine whether the transfer constituted a transfer of a covered asset. However, VA will disregard asset transfers made before October 18, 2018. In accordance with 3.277(a), for any asset transfer, VA may require a claimant to provide evidence such as a Federal income tax return transcript, the terms of a gift, trust, or annuity, or the terms of a recorded deed or other evidence of title."

Exceptions to transfer penalty

The result of fraud or unfair business practice. If a claimant transferred an asset as the result of fraud, misrepresentation, or unfair business practice "related to the sale or marketing of financial products or services for purposes of establish entitlement to VA pension", it will not be considered a covered asset and will not be

[30] 38 CFR §3.276 (a)(7)

penalized. Evidence must be provided to support the assertion, which could include a complaint filed with the proper authorities.[31]

Transfers to certain trusts. A Veteran, a Veteran's spouse, or the surviving spouse of a Veteran may transfer assets to a trust established on behalf of a child if the VA has rated the child incapable of self-support pursuant to 38 CFR §3.36 AND there is no circumstance where the trust assets can benefit the Veteran, the Veteran's spouse or the Veteran's surviving spouse.[32]

Calculation of the penalty period

There is a 5-year limit on any penalty imposed.[33] To calculate the penalty, the maximum annual pension rate for pension with an aid and attendance allowance with one dependent will be used for Veterans and surviving spouses who apply.[34] The monthly rate is figured by dividing the maximum annual amount by 12 and rounding down to the nearest whole dollar.

The penalty begins the first day of the month following the transfer. If more than one transfer was made the penalty begins the first day of month following the last transfer. [35] Entitlement to pension will begin the last day of the last penalty period month, with payment to begin the following month. [36]

Recalculation based on error or cure.

---

[31] 38 CFR §3.276(a)(8)(c)
[32] 38 CFR §3.276(a)(8)(d)
[33] *The proposed rules had a 10-year limit.*
[34] 38 CFR §3.276(e)(1) *The proposed rules would have only allowed for the MAPR for one dependent to be used for married claimants, while surviving spouses would have had to use the MAPR for a surviving spouse with no dependent.*
[35] 38 CFR §3.276 (e)(2)
[36] 38 CFR §3.276 (a)(7)(e)(3)

A penalty will only be recalculated if the original calculation was erroneous, or if the transferred assets were returned to the claimant before the date of the claim or within 60 days of the VA notifying the claimant of the penalty period.[37] This evidence must be received not later than 90 days after the notice of decision. Once the assets are returned, the penalty period will be removed. *Id.* The rules allow for a full or partial cure.

<u>Medical Expenses That May Be Deducted From Income</u>

The proposed and final rules undertook defining deductible medical expenses, as there was previously no statutory definitions for the purpose of VA pension. The definitions are found at 38 CFR §3.278(b).

The final rules expanded the definition of Activities of Daily Living (ADLs) to add “ambulating within the home or living area.”[38] Instrumental activities of daily living (IADL) includes “independent living activities, such as shopping, food preparation, housekeeping, laundering, managing finances, handling medications, using the telephone, and transportation for non-medical purposes.”[39]

Under 38 CFR §3.278(c), medical expenses for VA purposes are those that are “medically necessary; that improve a disabled individual’s functioning; or that prevent, slow, or ease an individual’s functional decline.”[40] This section continues to specifically identify medical expenses that meet the above definition.

---

[37] 38 CFR §3.276(e)(5) *The proposed rule only allowed a recalculation within 30 days of the claim, and only allowed 60 days for evidence to be received.*
[38] 38 CFR §3.278(b)(2)
[39] 38 CFR §3.278(b)(3)
[40] *The language, “prevent, slow, or ease an individual’s functional decline” was not in the proposed rules and was added as a result of public comments.*

1. Health care provider payments. Services must be performed within the scope of the provider's professional capacity.
2. Medications, medical supplies, medical equipment, medical food, vitamins and supplements. Prescriptions are recognized under this section as valid medical expenses, as are non-prescription medications obtained lawfully. Medically necessary food, vitamins and supplements are also recognized as long as prescribed by a health care provider authorized to write the prescription.
3. Adaptive equipment. Along with adaptive services, payments for service animals are included under this section, including veterinary care. However non-prescription food, boarding, grooming or other routine expenses are not recognized as a medical expense.
4. Transportation expenses. Mileage and public transportation expenses are included as long as the transportation is for medical purposes. Mileage for a privately owned vehicle is based on the reimbursement rate specified by the United States General Services Administration.
5. Health insurance premiums. Payments for long-term care insurance premiums are included, as well as health insurance and Medicare premiums for parts B and D.
6. Smoking cessation products.

7. Institutional forms of care and in-home care. Hospital charges, nursing home charges, medical foster home charges and inpatient treatment centers are allowable expenses, including the cost of meals and lodging. Payment for in-home care to assist with ADLs and IADLs will be considered valid medical expenses as long as health care or custodial care is provided.[41]

<u>More on home care and assisted living</u>

In-home care for a claimant who has not been rated in need of aid and attendance or housebound must be from a licensed health care provider before it can be deducted from income as a medical expense, unless a physician, physician assistant or other qualified medical professional states in writing that the claimant requires the health care or custodial care provide by the in-home attendant. [42]

<u>Care facilities other than nursing homes.</u>

The final rules provided much more clarification and leniency when it comes to care in a facility other than a nursing home or assisted living facility. 38 CFR §3.278(d)(3) covers care facilities other than nursing homes, and allows a medical expense deduction for care in such a facility that is either provided by the facility, contracted by the facility, obtained by a third-party provider, or provided by family or friends. The provider does not need to be a health care provider if the disabled individual needs aid and attendance or is housebound, or if a qualified medical

---

[41] *The cap on hourly rates for in-home care was removed in the final rules.*
[42] 38 CFR §3.278(d)(2) *The final rule is more liberal than the proposed rule which would have limited care by an in-home attendant unless rated housebound or in need of aid and attendance.*

professional states in writing that "due to a physical, mental, development, or cognitive disorder, the individual needs to be in a protected environment."[43] Meals and lodging will be deductible medical expenses if the facility provides or contracts for health care or custodial care, or a qualified medical professional states in writing that the individual must reside in the facility to separately contract with a third-party provider to receive health or custodial care or to receive health or custodial care from family or friends, whether paid or unpaid.[44]

Non-medical expenses

Except as noted previously, payments for the following are not medical expenses for VA purposes: General health maintenance expenditures, cosmetic procedures, meals and lodging (except as previously noted), or assistance with IADLs (except as provided above). [45]

Additional Statutory Exclusions From Income

The final rules added a few additional exclusions, and corrected citations to the United States Code (USC). All of the exclusions are listed below, with a notation as to whether the income is also excluded as an asset.

38 CFR §3.279 sets out all statutory exclusions from income or assets.

(a) Compensation or Restitution Payments.

1. Relocation payments. Excluded from income, included as an asset.
2. Crime victim compensation. Excluded from income and as an asset.

---

[43] 38 CFR §3.278(d)(3)(iii)(A)-(B)
[44] 38 CFR §3.278(d)(3)(iv)(A)-(B)
[45] 38 CFR §3.278(e)*The proposed rules also included VA fiduciary fees, but this was removed from the final rule.*

3. Restitution to individuals of Japanese ancestry. Excluded from income and as an asset.

4. Victims of Nazi persecution. Excluded from income and as an asset.

5. Agent Orange settlement payments. Excluded from income and as an asset.

6. Chapter 18 benefits. Excluded from income and as an asset.

7. Flood mitigation activities. Excluded from income and as an asset.

(b) Payments to Native Americans.

1. Indian Tribal Judgment Fund distributions. Excluded from income and as an asset.

2. Interests of individual Indians in trust or restricted lands. Excluded from income and as an asset.

3. Per Capita Distributions Act. Excluded from income and as an asset.

4. Submarginal land. Excluded from income and as an asset.

5. Old Age Assistance Claims Settlement Act. Excluded from income and as an asset.

6. Alaska Native Claims Settlement Act. Excluded from income and as an asset.

7. Maine Indian Claims Settlement Act. Excluded from income and as an asset.

8. Cobell Settlement. Excluded from income for one year and as an asset for one year.

(c) Work-Related Payments

1. Workforce investment. Excluded from income and included as an asset.

2. AmeriCorps participants. Excluded from income and included as an asset.

3. Volunteer work. Excluded from income and as an asset.

(d) Miscellaneous Payments.

1. Income tax refunds. Excluded from income and for one year as an asset.

2. Food stamps. Excluded from income and as an asset.

3. Food for children. Excluded from income and as an asset.

4. Child care. Excluded from income and included as an asset.

5. Services for housing recipients. Excluded from income and included as an asset.

6. Home energy assistance. Excluded from income and as an asset.

7. Programs for older Americans. Excluded from income and included as an asset.

8. Student financial aid. Excluded from income and as an asset.

9. Retired Serviceman's Family Protection Plan annuities. Excluded from income and included as an asset.

Waiver of Receipt of Income

Potential income that is not otherwise excluded may not be waived, except in one circumstance. If an individual withdraws a claim for Social Security benefits after a finding of entitlement in order to maintain eligibility for unreduced Social Security benefits after reaching a particular age, this will not be treated as a waiver and income will not be counted. [46]

Amendment to 38 CFR §3.551

[46] 38 CFR §3.271(i)

38 CFR §3.551(i) now includes a surviving child (in addition to Veterans without a spouse or child or a surviving spouse) as one whose benefits would be reduced to $90 upon entry into a nursing home and qualifying for Medicaid.

Conclusion

Time is of the essence in notifying clients, potential clients, and referral sources of these changes. The effective date of the new rules is October 18, 2018, which means all planning that includes transfers must be made before that date to avoid the lookback and penalty period rules.

ElderCounsel will be providing education on new opportunities that these rules provide for elder law attorneys and their clients. If you have any questions or wish to be notified up upcoming events, please email info@eldercounsel.com.