Get Medicaid Without Giving Up the Farm

A Medicaid applicant can keep his home and his eligibility. Here's how

By **Dennis M. Sandoval**, director of education,
American Academy of Estate Planning Attorneys, San Diego, Calif.

Getting Medicaid may not be a goal for clients worth hundreds of millions. But it very often is for the parents of Baby Boomers who've made it big, as corporate executives, doctors and the like. Increasingly, advisors are seeing clients with a net worth of $1 million to, say, $12 million who have parents in need of Medicaid. That parent couldn't or just didn't plan for long-term care. Now the threat is that the cost of such conditions as Alzheimer's Disease or senile dementia will run through millions of dollars over the years.

Very often, too, I see clients who started out worth $1 million to $2 million. But they've spent their liquid assets on medical costs and come for advice when all they have left is a home, worth about $500,00 to $1 million.

The question in both these common scenarios is: How to help the unwell qualify for Medicaid coverage so they can receive adequate care—without forcing their healthy spouses out of the family home and leaving nothing but, perhaps, debt for their children?

The parents of many successful Baby Boomers couldn't, or just didn't, plan for their long-term care.

Advisors need to know.

Federal law does allow an individual to own his residence, yet be covered under Medicaid.[1] The residence can be a single-family home, a condominium or townhouse, a cooperative apartment or a multi-family building in which the individual occupies one of the units as his primary residence. Unless the individual's spouse continues to reside in the residence, many states require that in order for the residence to be classified as exempt, it must be located in the state where the individual applies for Medicaid. There is no limit on the value of the residence, which includes its land and any related buildings, such as garages, pool houses and other outbuildings.

If the Medicaid applicant moves out of the residence (leaving it unoccupied or rented) and is placed in a nursing home, the residence retains its exempt character as long as the applicant (or his spouse) intends to return home. Depending on state regulations, the applicant may need to indicate this intent by checking the appropriate box on the Medicaid application or through some other document (often a trust or power of attorney). This expression of intent needn't be reasonable or supported by medical evidence. If the applicant moves out of the residence, leaving it occupied by a spouse or dependent relative, the house will be treated as exempt.

NEVER SAY FOREVER

Even when a residence is characterized as an exempt asset, a lawyer should not presume it is protected forever. Exempt status merely means that an asset is not counted in determining Medicaid eligibility and need not be sold to pay for nursing-home costs during an applicant's lifetime. In some circumstances, the state may place a lien on the residence during an applicant's lifetime, or it may make a claim against the estate of the deceased applicant or the estate of the deceased applicant's spouse.

Because of the special importance of the home in many legislators' eyes, there are laws specifically relating to the transfer of a home. Before the passage of the Medicare Catastrophic Coverage Act (MCCA) in 1988, only transfers of assets made for the specific purpose of qualifying for Medicaid were disqualified. Because the primary residence was exempt, its transfer had no bearing on Medicaid eligibility and could not be viewed as a transfer for the specific purpose of qualifying for Medicaid. Thus, there was an inconsistency in Medicaid laws in that the transfer of $10,000 cash might be a disqualifying event while in most circumstances the transfer of a $1 million home would not be.

After the passage of MCCA, participating states were required to impose a transfer penalty if an applicant transferred an interest in his residence for less than adequate consideration—unless it was a transfer of the residence to:

- The applicant's spouse;[2]
- A child of the applicant who is under age 21, or who is blind or permanently and totally disabled;[3]
- A sibling of the applicant who has an equity interest in the residence and has been residing there for a period of at least one year immediately before the date the applicant entered a nursing home (referred to from now on as institutionalization);[4] or
- A child of the applicant who lived in the applicant's residence for at least two years immediately before the date the applicant was institutionalized, and who (as determined by the state) provided care for the applicant that permitted him to stay in his residence, rather than be institutionalized.[5]

> The state may not touch the house while the Medicaid recipient is alive, but may make a claim against the estate after death.

Where the husband and wife own the residence together, protecting and preserving it may just be a matter of the couple executing a deed in favor of the non-institutionalized spouse (also called the "community spouse"). When the institutionalized spouse is incapable of executing a deed, the transfer may be achieved through a durable power of attorney for property (assuming the power of attorney contains the authority required under state law for making such a gift) or by way of a guardianship or conservatorship proceeding.

Once the home is transferred to the community spouse, she may retransfer it or create a testamentary special needs trust (TSNT) to provide for the supplemental needs of her institutionalized spouse in the event that she predeceases him. On the death of the institutionalized spouse, the remainder of the TSNT is distributed, free of claims from the state Medicaid agency, as provided in the trust document.[6]

But can the community spouse who has received an interest in the residence from an institutionalized spouse retransfer that interest to others without disqualifying the institutionalized spouse? The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) seems to indicate it may not be possible.[7] However, MCCA provides that the resources of the community spouse not be deemed available to the institutionalized spouse after he is found eligible for Medicaid.[8] The elderlaw attorney will need to investigate how a retransfer by the community spouse is treated in his state, as agencies have ruled differently on this matter.[9]

Of course, there is no denying that the retransfer of the residence by the community spouse (other than under one of the four exceptions outlined above) will cause the community spouse to be ineligible to receive Medicaid for a period of time, as provided by the divestment rules of each state.[10]

CAREGIVER DEFINED

A caregiver child is defined as a son or daughter of the applicant who resided in the applicant's home for a period of at least two years immediately before the date the applicant entered a nursing home, and who provided care to the applicant that permitted the applicant to live at home rather than in a

nursing home or similar facility. The care provided by this child must have been essential to the safety of the applicant and have consisted of activities such as, but not limited to, supervision of medications taken by the applicant, monitoring of the applicant's nutrition and ensuring the applicant's safety.

The California Department of Health Services has ruled that there is no transfer penalty as long as the residence is an exempt resource at the time of transfer by the applicant.[11]

What about circumstances where there is no spouse, disabled or minor child, sibling with an equity interest in the home or caregiver child to whom to transfer the residence? What planning strategies are available when the home has been transferred to the community spouse and steps must be taken to prevent recovery by the state Medicaid agency against that portion of the residence attributable to the institutionalized spouse on the community spouse's death? Here are some planning strategies to minimize transfer penalties and prevent recovery against the residence in the estates of either the institutionalized individual or the community spouse.

TRUST TRANSFER

Health Care Financing Administration (HCFA) Transmittal 64 states that Section 1613 of the Social Security Act provides that a home is an excluded resource for a community spouse.[12] Therefore, placing a residence in the Revocable Livng Trust (RLT) of the community spouse should not cause the residence to become a countable resource, of the institutionalized spouse. Thus, in those states that limit their estate recovery to the probate estate of the institutionalized spouse, an RLT for the community spouse can be a useful strategy to avoid recovery and pass the residence on to descendants. For those states that pursue recovery against non-probate transfers,[13] an RLT would be of no benefit in protecting and preserving the home.

An alternate strategy that would not cause the applicant to be disqualified from Medicaid coverage is the sale of a remainder interest in the residence. The value of the remainder interest would be calculated using the factors provided under HCFA Transmittal 64. Proceeds from the sale of the remainder interest would then have to be spent down or placed into the pool of assets for which an alternative Medicaid-planning strategy is being developed. On the applicant's death, the residence would pass to the person who had purchased the

remainder interest. None of the residence's value would be included in the applicant's estate, and the basis in the residence for the remainderpersons would be the amount paid for the remainder interest.

The following is an example of how this strategy might work: A client, age 75, needs to enter a nursing home within the next year. The client owns a home with a fair market value of $200,000. The factor for a remainder interest for a 75-year-old under HCFA Transmittal 64 Tables[14] is .47851. The sale price for the remainder interest would be $95,702. The client can then take the $95,702 and spend it or engage in various Medicaid-planning strategies, such as the purchase of exempt assets, half-a-loaf or an annuity in order to qualify for Medicaid coverage. The remainderpersons would receive the residence, worth at least $200,000, by operation of law at the death of the client. The remainderpersons' basis in the residence would be $95,702.

Factors that the elderlaw attorney should consider in determining whether or not a transfer for fair market value might be appropriate are:

• The residence's value, to determine the financial feasibility for both parties of a sale of the remainder interest;

• The client's anticipated life expectancy, to estimate the potential recovery by the state healthcare agency;

•The loss of step-up in basis on the residence at the client's death;

• whether the client has a need for funds to private pay for a period of time;

•In the event funds are not needed, the availability of half-a-loaf and other Medicaid-planning strategies to transfer the funds received to pay for the remainder interest.

DEED SECURITY

The execution of a deed transferring the residence to family members, but with the reservation of a life, is one of the simplest strategies to preserve the residence from family members. Because the property passes outside probate by operation of law, there would be no recovery in states that limit recovery to the probate estate. For states that have expanded their recovery to non-probate assets, there could be a recovery—but OBRA-93 limits that recovery to the value of the client's life estate, which diminishes as the client ages.

Many clients like life estates because of the security a recorded deed affords. They need not worry that their children are going to kick them out of their home, and in most states, a creditor of the remainderpersons would receive a judgment subject to the life estate and could not force a partition of the property. Life estates also allow the client to continue to receive any property-tax abatements to which, as a senior, he may be entitled.

Because the retention of a life estate is considered a lifetime transfer with a retained life interest, the value of the residence will be included in the client's estate at death under IRC Section 2036(a). The inclusion in the client's estate causes the residence to receive a full step-up in basis under Section 1014, thereby reducing capital-gains taxes paid by the remainderpersons in the event that the residence is sold after death.

If the home is sold prior to the client's death, in many circumstances, the client would be eligible to use his $250,000 Section 121 exclusion from gain against that portion of the gain attributable to the life estate.[15] Unless the remainderpersons are also occupying the property as their residence, they would be ineligible to use the Section 121 exclusion against their gain on sale. The remainderpersons' basis in the property would be equal to the life tenant's basis prior to the transfer with the life estate, multiplied by the proper IRS remainder factor under Table S at Treasury Regulation Section 1.2031-7T(d)(7).

If the property is sold during the client's lifetime, the sale proceeds associated with the life estate would be payable to the client and would be considered countable income for Medicaid-eligibility purposes.

Except in California, the use of a life-estate deed will cause the client to be disqualified for a period of time based on the remainder value of the residence as provided under HCFA Transmittal 64. For instance, for a 75-year-old client in a state with an average monthly nursing-home cost of $5,000 and a home valued at $200,000, the period of ineligibility would be 20 months.[16]

For maximum flexibility of income-tax, gift-tax and Medicaid-planning purposes, some elder-law practitioners favor using a life-estate deed where the remainder interest is revocable or where the deed is subject to a special power of appointment.[17] The revocable remainder allows the applicant to use his Section 121 exclusion against the total sales price of the residence if it is sold during the applicant's lifetime, assuming the remainder interest is revoked, and prevents a completed gift for gift-tax purposes. However, the California Court of Appeals has held that the Department of Health Services could recover against revocable life estate.[18] The retention of the special power of appointment allows the client to direct the remainder interest away from a transferee who later becomes disfavored and may have developed creditor or marital problems.

OUTRIGHT TRANSFER

An alternative to the deed to children with a retained life estate is an outright transfer of the residence combined with a written occupancy agreement between the client and his children or other designated transfer-

ees. In some states, this occupancy agreement would need to be in a form that is recordable.

One purported advantage of this strategy is that the transferees can sell the residence if it is unlikely that the applicant will be able to return home, assuming the unrecorded occupancy agreement is ignored. Another advantage is greater ease for the transferees in accessing the equity in the residence through financing (there is no need to involve the applicant in the financing process as he would no longer be an owner of record). As a result of the client's retained right to occupy the residence under the occupancy agreement, the residence would be includable in the client's estate under Section 2036 and the remainderpersons would have a basis in the residence equal to its fair market value at the client's date of death.

If the property is sold during the institutionalized individual's lifetime, the income tax treatment of the institutionalized individual and the transferees would be the same as that described earlier for the sale of a property subject to a life estate.

As with the strategy employing a life-estate deed, an outright transfer of the residence with an occupancy agreement will cause the client to be disqualified for a period of time based on the remainder value of the residence. The calculation of the disqualification period would be done in the same manner as with a life estate.

A potential disadvantage of this strategy is that it leaves the client with greater exposure to the creditors of the transferees than is the case when a deed with retained life estate is used. Because the occupancy agreement is unrecorded, this arrangement also leaves the senior with the least amount of security in the event that the relationship between the client and the transferee sours or the transferee dies or suffers a divorce or business failure.

IRREVOCABLE TRUST

When there are concerns regarding the transferees' creditors, a potential divorce or a business failure of one or more of the transferees, the use of an irrevocable income-only trust will often prove the best option.[19] Upon the client's death, the home remains in trust for the benefit of the transferees, affording them valuable asset and divorce protection. When the client wants the home to remain a family asset for multiple generations, the trust can be structured as a generation-skipping or dynasty trust.

The irrevocable trust must be

structured as an income-only trust with no access to principal by the client.[20] Because this is a transfer to a trust, the 60-month look-back period under OBRA-93 will be invoked.[21] After the penalty period for the residence's transfer to the trust has expired, the residence should be classified as a non-countable resource for Medicaid-eligibility purposes.

However, if the irrevocable trust contains terms that would allow principal payments from the trust to be made to the client or for his benefit, the home will be considered a countable asset just like any other real estate, other than an exempt residence, owned by the client.

Assuming that the trust is drafted to be a grantor trust for income tax purposes,[22] the client should be able to use his Section 121 exclusion if the residence is sold during his lifetime. If the residence is held until the client's death, the residence should get a step-up in basis to fair market value due to inclusion of the trust in the client's estate for federal estate-tax purposes under Section 2036, thereby minimizing capital-gains taxes to the transferees on subsequent sale of the residence.

Because the irrevocable income-only trust is a non-countable asset for Medicaid-planning purposes, any proceeds from a lifetime sale of the residence would not be treated as countable resources.[23] In states that limit Medicaid recovery to the probate estate, the home would not be subject to recovery. For states that have extended their recovery abilities to non-probate assets, recovery would be limited to the value of the client's income interest in the trust as of his date of death.

The disadvantages of the irrevocable income-only trust are: loss of access to principal by the client; the extended 60-month look-back period; the problems and delays of dealing with government personnel who may not be familiar with the technicalities of using a trust for Medicaid planning; and the uncertainty of how federal and state Medicaid laws may be changed in the future.

Transferring a remainder interest in the home to an irrevocable trust combines the shorter transfer-penalty period of the life-estate option described earlier with the asset-protection and income tax advantages of an outright transfer of the residence to an irrevocable income-only trust. In addition, because of the retention of the life estate, this strategy addresses many seniors' concern about giving up complete control of their right to occupy their home and the problems associated with that loss of power.

But the tactic has drawbacks, too: should the property be sold during the client's lifetime, the sale proceeds associated with the life estate would be countable income for Medicaid-eligibility purposes; the 60-month look-back period; and the problems and delays of dealing with government personnel who may not be familiar with the technicalities of using a life-estate deed combined with a remainder interest in a trust for Medicaid-planning purposes.

By the time many seniors ask an attorney for advice on paying for nursing home costs, they've already spent down most of their liquid assets and their residence is the only significant asset left. The strategies I've outlined can help them qualify more quickly for Medicaid coverage and lessen their anxieties over preserving that residence for a spouse, disabled child or other family members. ▮

Endnotes

1. 20 CFR Section 416.1212 and Social Security Program Operations Manual System (POMS) SI 01130.100.
2. 42 U.S.C. Section 1396p(c)(2)(A)(i).
3. 42 U.S.C. Section 1396p(c)(2)(A)(ii).
4. 42 U.S.C. Section 1396p(c)(2)(A)(iii).
5. 42 U.S.C. Section 1396p(c)(2)(A)(iv).
6. 42 U.S.C. Section 1396p(d)(6).
7. 42 U.S.C. Section 1396p(c)(1)(A).
8. 42 U.S.C. Section 1396r-5(c)(4).
9. CMS (Center for Medicare and Medicaid Services, formerly HCFA) officials from Region I, Region VIII and Region X, as well as the assistant counsel for the Bureau of Health and Long Term Care Law of the New York Department of Social Services, have stated that a post-eligibility transfer by the community spouse should not be the disqualifying event for the institutionalized spouse. The deputy secretary for Income Maintenance of the Pennsylvania Department of Public Welfare and the court in *Thompson v. State of Connecticut* Dept. of Social Services, 1999 WL 1120130, No. CV 980063936 (Conn. Super. Ct., Nov. 23, 1999) have ruled contra.
10. For instance, if the average monthly cost of nursing-home care is $8,000 and the value of the residence is $240,000, there would be a 30-month Medicaid ineligibility period for the community spouse.
11. California Department of Health Services All County Letter No. 00-11 (March 14, 2000); 22 California Code of Regulations Section 50408 (Barclays 2003).
12. HCFA Transmittal 64 at Section 3259.6.F.
13. 42 U.S.C. Section 1396p(6)(4) provides that a state may define "estate" for recovery purposes to include "real and personal property and other assets in which the individual had any legal title or interest at the time of death...."
14. HCFA Transmittal 64 at Section 3258.9.A.
15. Treasury Reg. Section 1.121-4(f)(2)(ii).
16. $200,000 x .47851 = $95,702. $95,702 / $5,000 = $19.14.
17. For more on life estate deeds with special powers of appointment, see "Proper Medicaid Planning May Permit Keeping the Home in the Family" by Brian Barreira, 28 Estate Planning Journal 4 (April 2001).
18. Bonta v. Burke, 98 Cal.App.4th 788, 120 Cal.Rptr.2d 72 (2002).
19. See the author's article, "Drafting Trust for Maximum Protection from Creditors," in 30 *Estate Planning Journal* 6 (June 2003) for more information of drafting trusts for asset protection.
20. HCFA Transmittal 64 at Section 3259.1.A.8.
21. 42 U.S.C. Section 1396p(c)(1)(B)(i).
22. This can be done by including one or more of the powers in IRC Sections 671-678. For more information, see "Income Taxation of Fiduciaries and Beneficiaries" by Byrle Abbin (2002 Panel Publishers).
23. This is because the trustee has no discretion to distribute principal to the client.