PROTECTING ASSETS UNDER THE DEFICIT REDUCTION ACT

Background: The Deficit Reduction Act

The Deficit Reduction Act of 2005 (DRA), signed into law in February 2006, set the stage for some of the most significant changes to Medicaid since the program's inception in 1965. It amended a number of other federal programs and aimed to achieve savings of nearly $100 billion for the federal government over a 10-year period, netting an estimated $28 billion or more from adjustments to Medicaid.

The most significant DRA change is that Transfer Sanctions will not begin to run until both of the following conditions have been met: (i) the applicant is in a nursing facility with a physician's formal approval and (ii) the applicant is otherwise financially qualified for Medicaid (other than the fact that there will be a Transfer Sanction). Also, rounding down no longer applies and fractional Transfer Sanctions will be in force.

The lookback date is the earliest point in time on or after which all transfers of assets are reviewed for the a/r requesting or receiving institutional services.

1. For applications taken on or after November 1, 2007, the lookback period for transfers, including transfers to trusts and annuities, is 60 months prior to the starting point. The full 60 months will be phased in until the year 2012 is reached. For applications prior to November 1, 2007, the lookback period remains 36 months, except for transfers to trusts and annuities. In this case the lookback period is 60 months.

2. For individuals who first applied for Medicaid in any category on or after February 1, 2003, but prior to November 1, 2007, the starting point is the date of the first application for Medicaid. For individuals who first applied for Medicaid in any category prior to February 1, 2003, or on or after November 1, 2007, the starting point is the earliest date the a/r is institutionalized or requests CAP and applies for Medicaid.

The allowable transfer's policy is revised to make it clear that a compensated transfer of real or personal property or liquid assets is an allowable transfer.

Under the DRA fractional portions of a month are included when determining the sanction period. Previously, the fractional period was dropped.

Additional changes to the Medicaid transfer of asset rules include making additional assets subject to the lookback period and imposition of a sanction period if the asset was established or transferred for less than fair market value. These assets include funds used to purchase a promissory note, loan, or mortgage. The purchase of life estate interest must meet certain criteria.

The DRA also addresses the increased use of annuities to shelter assets. As a condition of eligibility for institutional services, the State must be named the remainder beneficiary of all annuities held by the a/r or the a/r's spouse that are purchased or changed on or after November 1, 2007. Unless an annuity meets certain criteria, a transfer of assets sanction

on annuities purchased or changed must be imposed. The criteria are outlined in policy. The DRA amended Section 1917 of the Act to impose a home equity limitation of $500,000 for persons requesting assistance for institutional services.

The $500,000 home equity provision does not apply to individuals who applied and were determined eligible before November 1, 2007, and have no break in institutional services eligibility after November 1, 2007, or to a re-open termination when the date of application is prior to November 1, 2007.

The new MA-2242, Notification of Right to Request a Demonstrated Hardship Waiver (Home Equity Value), notifies the a/r of the right to request a demonstrated hardship waiver.

Changes affecting eligibility policy include:

Definitions for the following are added or revised: actuarially sound, annuity, annuitant, annuitize, beneficiary of an annuity, cost of care, demonstrated undue hardship, greater weight of the evidence, in-home health services and supplies, institutional services, institutionalized for transfer of assets, legal representative, lookback date, rebuttal, remainder beneficiary, sanction period, transfer, uncompensated value, undue hardship, and undue hardship waiver.

Since passage of the DRA, non-countable, or ("exempt") assets may now include:

The homesite (personal residence) and contiguous real property is exempt up to $500,000 in equity (individual states may choose to increase the exemption for the home to $750,000 in equity)

Changes to Personal Residence Rules:

DRA eliminates Medicaid eligibility for those single individuals having more than $500,000 in equity value in a primary residence. An unlimited exemption for the home remains if it is occupied by a spouse, child under age 21, or disabled/blind child of any age.

Homeplace Limit.

- Will likely affect farmers – traditionally could exempt house and all surrounding land;
- If have spouse, disabled or minor child home is still exempt.

Changes to Life Estate:

DRA essentially penalized creating any life estate other than through the purchase of a life estate in property which the Medicaid applicant/recipient then uses as his/her primary

residence for at least one year.

The provision that will most commonly affect seniors is imposition of a transfer penalty for gifting a remainder interest in land to children. Single individuals who wish to gift a remainder interest in property must do so well in advance of needing institutionalized care due to the new five-year look-back period. Otherwise, they will incur a significant penalty in Medicaid eligibility.

In reality, few seniors purchase life estates. Far more life estates are created by the gift of a remainder interest in property to children. Prior to the DRA, there was significant reason to advise seniors to reserve a life estate. [1]Retained life estate interests offered important protections for the grantor against losing control of the residence. [2]Remainder interest holders benefit from a possible step-up in basis reducing capital gains tax. [3]Transfer of a remainder interest resulted in a shorter Medicaid transfer penalty versus transferring the entire property.

DRA will significantly impact retained life estates. Although the retained life estate interest may still be Medicaid-exempt, the gift of the remainder will not be penalized until the applicant is "otherwise eligible" for Medicaid.

For a transfer of a homesite on or after November 1, 2007, to a co-owning sibling to remain an allowable transfer, the sibling must have been residing in the home for a period of at least one year immediately before the a/r entered a nursing facility or requests CAP. For a transfer of a homesite to a natural, adopted, or step child(ren) age 21 or over to remain an allowable transfer, the natural, adopted, or step child(ren) age 21 or over must have been residing in the home for a period of at least two years immediately before the a/r entered a nursing facility or requests CAP and provided care to the a/r to permit him to live at home during the two year period. Receiving in-home health services and supplies is not a factor for transfers made on or after November 1, 2007.

DSS will evaluate for a transfer of assets when an individual transfers real property and retains a life estate interest, transfers a life estate interest, or purchases a life estate in another individual's home or other asset.

DSS will evaluate purchase of a remainder interest in real property and of a tenancy-in-common interest or other fractional interest in real property for fair market value at least equal to the value of the purchase price and evaluate transfer of a remainder interest in real property and of a tenancy-in-common interest or other fractional interest in real property for compensation at least equal to fair market value.

When evaluating rebuttal evidence provided by the applicant, the social worker should consider regular donations/gifts to charities, religious organizations or family members to determine a pattern of giving. A pattern of giving can indicate an intent other than to qualify for Medicaid.

Whenever a transfer of asset sanction is determined, regardless of the date of the transfer, the applicant may request an undue hardship waiver. A new manual section containing policy reflecting the new G.S. 108A-58.2 requirements for when an applicant/recipient alleges an application of a transfer of asset sanction would cause an undue hardship. If imposition of the transfer of asset sanction would cause the a/r an undue hardship, Medicaid eligibility may be authorized for the sanction period.

Undue hardship relates to the applicant. Undue hardship does not apply to relatives, responsible parties of the a/r or the facility. Undue hardship also does not exist when the imposition of the penalty period causes the applicant(a/r) an inconvenience or restricts his lifestyle.

Undue hardship exists when imposition of a penalty period due to the asset transfer would deprive the a/r of:

1. Medical care such that the a/r's health or life would be endangered, or food, clothing, shelter, or other necessities of life, and

2. No other sources are available to the a/r to provide for medical care, food, clothing, shelter, or other necessities of life, and

3. The a/r or a person or institution acting on the a/r's behalf is making a good faith effort to pursue all reasonable means to recover the transferred asset or the fair market value of the transferred asset.

Annuities purchased or changed on or after November 1, 2007, must name the State of North Carolina Medicaid Program as the remainder beneficiary in the first position when the a/r is applying for or receiving institutional services or requests CAP. If there is a community spouse or any child under age 21 or a disabled child of any age when the purchase or change takes place, the North Carolina Medicaid Program may be named in the second position after one of those individuals.

At application and review, an a/r or person or institution acting on his behalf must disclose to the agency the existence of any annuities held by the a/r or the spouse of the a/r.

Where the annuity is actuarially sound (returns its entire value during the annuitant's life expectancy) it may not be considered an available resource for eligibility purposes. The client must purchase an immediate annuity rather than a deferred annuity in which payments under the
Contract must begin within one year following the initial premium payment.

Long Term Care Insurance

Forty-five percent of Americans will have to pay for some kind of long-term care services. Insurance could preserve your estate for your heirs, however it is expensive and chances are you won't need it.

Due to advances in medicine and a greater understanding of how we stay healthy, we're all living longer. Those over age 65 makeup the fastest growing segment of our society. Changes in families (more childless, one- child and step-families) and the increasing participation of women in the work force, mean that the numbers of those available to provide informal care for aging baby boomers is decreasing.
Women experience greater longevity and accumulate fewer assets than their male counterparts, making it even more crucial for them to plan ahead for their own quality of care.

If a debilitating illness runs in your family, your odds of needing expensive long term care insurance increase. Do not buy unless you can afford a premium hike of 10% to 20 % and can continue to make payments for 30 or so years. Money magazine suggests a person spend no more than 7% of your income on premiums. (Justin Martin, Long Term Care Insurance: When it Makes Sense, May 2008) If at any point you are unable to pay, you will likely be left with no coverage at all. Then the money would really have been wasted.

You may choose between a "tax qualified" long term care insurance policy and one that is "non-tax-qualified". Important differences were created by the Health Insurance Portability and Accountability Act (HIPPA).

Taxpayers may be able to deduct part of the premiums paid for qualified LTC coverage insuring themselves, their spouse or a dependent. I.R.C. secs 7702B(a)(4) and 213(d)(1). The part of each premium that may be deductible depends on the insured's attained age at the close of the taxable year and is indexed each year for inflation. I.R.C. S213(d)(10).

If the contract is a reimbursement policy, the entire benefit received is excluded from income as an expense incurred for medical care. I.R.C. SS7702B(a)(2) and 104(a)(3).
If the contract is a per diem policy, the benefit received is added to any amounts received by chronically ill taxpayers as accelerated death benefits or viatical settlements. The aggregate exclusion for these items in 208 is limited to $270. I.R.C. SS7702B(d) and Revenue Procedure 2005-70;2005-47I.R.B.979.

Qualified Long Term Care (QLC) insurance contracts must satisfy rigorous requirements set forth in the tax law and elsewhere. Those requirements include mandatory contract provisions relating to renewal, nonforfeitability, cash value, loans, dividends, premium returns and integration with Medicare. Long term care insurance purchased prior to January 1, 1997 can be "grandfathered" or considered qualified, even though they may not meet all of the standards. To be qualified, policies must be labeled as tax qualified, must be guaranteed renewable, include a number of consumer protection provisions, cover only qualified long-term care services, and generally can provide only limited cash surrender values.

Deduction for QLC Insurance Premiums

Amounts paid for insurance that covers qualified long-term care services are treated as medical expenses up to specified dollar limits that vary with the age of the taxpayer as of the close of the tax year. For a taxpayer age 40 or younger, the 2008 limit will be $310, over 40, but not more than 50, $580, more than 50 but not more than 60, $1,150, more than 60 but not more than 70, $3,080, and more than 70, $3,850.00.

Premiums paid by a self employed individual
A self-employed individual may deduct QLC premiums as business expenses.

Comparison with nonqualified insurance
An NLC insurance contract paying benefits for personal injuries or sickness normally will qualify as accident or health insurance (A&H insurance). This is deductible only to the extent of the insurer's reasonable estimate of the portion allocable to future medical expense reimbursements.

If taxpayer's employer pays the premiums, they are generally excludable in their entirety.

Benefits are entirely excludable if the taxpayer paid all the insurance premiums. Includable to the extent attributable to employer premium payments that do not reimburse specific medical expenses includable if the employer paid all the premiums.
If an employer pays all the premiums under an A & H contract, gross income those benefit payments not reimbursing specific medical expenses.

If a medical professional says you need daily skilled care after you have been in the hospital for at lest three days and you are receiving that care in a nursing home that is a Medicaid-certified skilled nursing facility. Medicare may cover up to 100 days of skilled nursing home care per benefit period when these conditions are met. After 20 days, beneficiaries must pay a co-insurance fee.

Whether you should buy a long term care insurance policy will depend on your age, health status, overall retirement goals, income and assets. If your only source of income is a Social Security benefit, you probably should not buy long term care insurance since you may not be able to afford the premium.
If you have a large amount of assets but don't want to use them to pay for long term care, you may want to buy a long-term care insurance policy.
If you already have health problems and you are likely to need long term care, you probably won't be able to buy a policy.

One "pooled benefit" covers more than one person such as a husband and wife, or two or more related adults. This type of benefit is sometimes called a "joint policy" or a "joint benefit". It usually has a total benefit that applies to all of the individuals covered by the policy.

Another kind of "pooled benefit" provides a total dollar amount that can be used for various long-term care services. You can combine benefits in ways that best meet your

needs. You may choose to combine the benefit for home health care with the benefit for community based care instead of using the nursing home benefit.

Other Long-Term Care Insurance Policy Options You Might Choose

Waiver of Premium
Premium waiver lets you stop paying the premium once you are eligible for benefits and the insurance company has started to pay benefits.

Restoration of Benefits
With this option, if you fully recover after a prior disability and go for a stated period without needing or receiving long term care services, the benefit goes back to the amount you first bought.

Premium Refund at Death
This benefit pays your estate any premiums you paid minus any benefits the company paid.

Downgrades
Most insurers let policyholders reduce their coverage if they have trouble paying the premium.

What Happens if You Can't Afford the Premiums Anymore?
If, for whatever reason, you drop your coverage and you have a nonforfeiture benefit in your policy, you will receive some benefit value for the money you have paid into the policy.

Can You Renew Your Long Term Care Insurance Policy?
Insurance companies can raise the premiums on their policies but only if they increase the premiums on all policies that are in the same state. If you bought a policy in a group setting and you leave the group, you may be able to keep your group coverage or convert it to an individual policy but you may pay more.

The average annual premiums for basic long term care insurance ($100 daily benefit amount, four years of coverage, and a 20 day elimination period) that does not include a 5% compound inflation protection option were:

- $300 for a 40 year old
- $409 for a 50 year old
- $1,002 for a 65 year old; and
- $$4166 for a 79 year old.

The average annual premiums for the same policy with both the 5% compound inflation protection option and the nonforfeiture benefits option were:

- $798 for a 40 year old

- $1,087 for a 50 year old
- $2,130 for a 65 year old; and
- $7,000 for a 79 year old.*

*Health Insurance Association of America (HIAA) survey. "Research Findings: Long Term Care Insurance in 1998-1999" February 2002. Table 5. p. 26. "Average Annual Premiums for Leading Long-Term Care Insurance Sellers in 1999."

When you buy a long-term care policy, think about how much your income is and how much you could afford to spend on a long-term care insurance policy now, what your future income and living expenses are, and how much premium you can pay then. Can you afford a rate increase on your policy some time in the future?

You should CONSIDER buying Long-Term Care Insurance if:

- You have significant assets and income.
- You want to protect some of your assets and income.
- You can pay premiums, including possible premium increases, without financial difficulty.
- You want to stay independent of the support of others.
- You want to have the flexibility of choosing care in the setting you prefer or will be most comfortable in.

 Extension of Long Term Care partnership policy available in all 50 states. This allows a person who purchases a policy in the same state where they need LTC to exempt the amount of assets equal to policy coverage or states can waive asset rules completely.

 Still subject to income rule

 States must elect to be included

 Will require LTC policies to contain very specific terms:

1. compounded inflation protection if issued under 61
2. some inflation protection over 61
3. must be IRS qualified
4. meet long term care insurance model Act requirements

 only effective for policies issued after state adopts amendment

<u>Loans</u>

 Must be actuarially sound

 Note paid back over life expectancy doesn't permit deferral, balloon

payment or cancellation at death.

_ Payments must be equal.

Additional changes to the Medicaid transfer of asset rules include making additional assets subject to the lookback period and imposition of a sanction period if the asset was established or transferred for less than fair market value. These assets include funds used to purchase a promissory note, loan, or mortgage. The purchase of life estate interest must meet certain criteria.

Medicaid Planning:

- One-half loaf won't work because clock doesn't start ticking until otherwise would qualify
- Reverse one-half loaf may work

Very important planning exceptions are available. Transferring assets to certain recipients will not trigger a period of Medicaid ineligibility. These exempt recipients include:

(1) A spouse (or anyone else for the spouse's benefit);

(2) A blind or disabled child;

(3) A trust for the benefit of a blind or disabled child; or

(4) A trust for the benefit of a disabled individual under age 65 (even for the benefit of the applicant under certain circumstances).

Special rules apply with respect to the transfer of a home. In addition to being able to make the transfers without penalty to one's spouse or blind or disabled child, or into trust for other disabled beneficiaries, the applicant may freely transfer his or her home to:

(1) A child under age 21;

(2) A sibling who has lived in the home during the year preceding the applicant's institutionalization and who already holds an equity interest in the home; or

(3) A "caretaker child," who is defined as a child of the applicant who lived in the house for at least two years prior to the applicant's institutionalization and who during that period provided such care that the applicant did not need to move to a nursing home. For a transfer of a homesite on or after November 1, 2007, to a co-owning sibling to remain an allowable transfer, the sibling must have been residing in the home for a period of at least one year immediately before the a/r entered a nursing facility or requests CAP. For a transfer of a homesite to a natural, adopted, or step child(ren) age 21 or over to remain an allowable transfer, the natural, adopted, or step child(ren) age 21 or over must

have been residing in the home for a period of at least two years immediately before the a/r entered a nursing facility or requests CAP and provided care to the a/r to permit him to live at home during the two year period. Receiving in-home health services and supplies is not a factor for transfers made on or after November 1, 2007.

If a homesite is transferred to more than one natural, adopted, or step child (ren) who meet the criteria for residing in the home and caring for the a/r, this is an allowable transfer.

A transfer can be cured by the return of the transferred asset in its entirety.

Spousal Impoverishment Protections

Medicaid Planning Techniques

Many important elements of traditional "Medicaid planning" will remain unchanged. Married client will still need to have Will with a discretionary trust for the benefit of the spouse if there is any likelihood of institutionalized care. "Will alternative" to bypass the probate estate where there is any possibility of future estate recovery claims. Concepts of transforming countable assets into exempt resources and wise divestment of assets remain largely unchanged.

Purchase of Life Estate Interests

Deficit Reduction Act of 2005 now penalizes purchasing a life estate unless it is in a residence and the applicant/recipient actually lives in the home for one year following the purchase. The DRA penalizes purchased of a life estate in any property other than a residence.

Reverse mortgages may become useful now that DRA reduces the options for intergenerational gifting. In life of the more severe restrictions on government long-term care assistance, children should very closely account for the assistance they provide and treat such assistance as a loan, secured against assets (more likely the house) owned by the parent.

One area in which DRA significantly changes planning for married couples is the purchase of an annuity.

One approach for short term planning under the DRA involves the use of a short-term immediate annuity, a person can become "otherwise eligible" by keeping less than the resource allowance, and still maintain a source of funding nursing home payments during the penalty period. For an example, an individual who has assets worth $40,000 might transfer $20,000 to his children and as the same time purchase an immediate annuity that pays $5,000 per moth for a period of 4 months; following day the individual enters a nursing home. The penalty period begins to run upon the filing of an application for benefits. The nursing home payments are made through the four-month penalty by using the monthly annuity payments.

Irrevocable grantor trusts remain viable, as an advance planning technique individuals

who can retain sufficient resources to pay for five years.

Factors which must be considered include loss of control and income level of the senior. Include options that should be explored in spousal planning, caregiver agreements, use of DRA-compliant annuities or promissory notes, and the use of pooled trusts.