

Attorney Ann I. Weber

Estate Tax Planning, Estate Administration, Probate, and Elder Law

Ann I. Weber, Esquire

Shatz, Schwartz and Fentin, P.C.

1441 Main Street

Springfield, MA 01103

(413) 737-1131

aweber@attorneyannweber.com

Checklist for Financial Planning

for Families with a Disabled Family Member

Under the Deficit Reduction Act of 2005

On February 1, 2006, Congress passed the Deficit Reduction Act of 2005 (“DRA”). This Act included provisions restricting planning options of seniors facing long term care. While Medicare combined with most supplemental insurance programs, such as Blue Cross/Blue Shield, covers medical and hospitalization costs associated with acute illnesses, neither covers chronic or long term illness requiring nursing home care. As a result, without planning, those individuals unfortunate enough to contract a debilitating illness requiring long term care face financial ruin in the absence of some assistance from the Medicaid program.

In the past, under the “Fair Share Rules”, individuals have been able to make certain types of transfers to family members and then, after an initial disqualification period, qualify for medical assistance. Married individuals have been able to rearrange their assets so that the community spouse retains the maximum amount allowed by law while converting additional assets into annuities which pay out within the life expectancy of the community spouse. The DRA has rearranged and, in some cases, curtailed some of the planning options offered under the Fair Share Rules, but, with careful planning, many opportunities remain.

The following checklist was designed as a reference for families in which one or more members have been diagnosed with a long-term illness. As soon as possible after receiving such a diagnosis, the family member in charge of financial matters (either as a matter of course or as a result of abdication by the ill family member) should review this checklist and consult a knowledgeable attorney to determine whether these items apply to his or her individual situation.

Warning:

Laws and regulations in this area change frequently. In particular, regulations under DRA have only recently been issued by the Commonwealth. The planning suggestions listed below will almost certainly be modified as the meaning of these regulations is clarified by administrative and judicial decisions... Furthermore, there are constitutional challenges to DRA pending on the federal level. Consequently, it is critical to consult a knowledgeable attorney to update this material and tailor a plan to your particular circumstances and the law in effect at the time.

FINANCIAL PLANNING CHECKLIST:

1. GATHER TOGETHER ALL FINANCIAL DATA.

The cornerstone for all effective financial planning is an accurate working knowledge of financial resources and liabilities. This is even more critical under the new law. A list should be made of all assets owned by the ill individual (and his or her spouse, if married) and how title is held, i.e., in one name alone, jointly with a right of survivorship, jointly as tenants in common with no right of survivorship, etc. Such a list should, at a minimum, include the following:

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a. ASSETS.

- (i) Cash (checking, savings and certificates of deposit). For C.D.'s, the maturity date should be listed.
- (ii) Bonds, listed stocks and money market funds.
- (iii) Unlisted stocks, closely held business or partnership interests.
- (iv) Any notes which are owed by or payable to the family member.
- (v) Personal property (furniture, car, boat, jewelry, antiques, etc.).
- (vi) Real estate, including the cost, current fair market value and assessed value of the individual's home, vacation home, investment land or other real property. Mortgages, if any, should be listed along with the amount of the outstanding principle.
- (vii) Any business interests not listed above.
- (viii) Life insurance, noting the type of insurance, such as ordinary whole life or term, the face amount and cash value, if any, and the named beneficiary.
- (ix) Interest in pension and/or profit sharing plans, IRA, Keogh or Section 401(k) accounts.
- (x) Any other employment-related benefits, such as disability benefits, deferred compensation benefits, etc.
- (xi) Anticipated inheritance from relatives.

b. INCOME.

- (i) Earned income for wages, bonuses, etc.
- (ii) Disability income.
- (iii) Rental income.
- (iv) Pension, profit-sharing, retirement income.
- (v) Social Security.
- (vi) Investment income.

2. MAKE AN APPOINTMENT WITH AN ATTORNEY KNOWLEDGEABLE IN THE ESTATE PLANNING/MEDICAID FIELD AND CONSIDER VARIOUS PLANNING ALTERNATIVES, SOME OF WHICH ARE LISTED BELOW.

3. CONSIDER HAVING THE ILL INDIVIDUAL EXECUTE A DURABLE POWER OF ATTORNEY.

A durable power of attorney allows one person, called the attorney-in-fact, to act on behalf of the grantor of the power and continues in effect even if the grantor becomes disabled. Such a power allows the attorney-in-fact to step into the shoes of the grantor and to make any and all decisions authorized by the document. It is a powerful estate planning tool; perhaps the most critical in financial planning for individuals with a long term illness because it allows the ill individual to designate the person who will make decisions when he or she is no longer able to do so. The ability for such power to be misused requires a high degree of trust in the integrity of the attorney-in-fact; granting someone such a power should always be approached with caution. Properly used, however, a durable power of attorney often avoids the need for a guardianship when the grantor of the power can no longer manage his or her affairs.

Consider giving a trusted attorney-in-fact the power to transfer or make gifts of the grantor's property. Obviously, this confers very broad power on the attorney-in-fact and should not be included unless the relationship between the parties is very solid. Consult with attorney regarding possible tax consequences of this power to the attorney-in-fact.

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4. INQUIRE AS TO WHETHER THE ILL INDIVIDUAL HAS OR IS INTERESTED IN A HEALTH CARE PROXY OR A LIVING WILL.

Although Massachusetts courts have recognized the right of an individual to limit the types of medical treatment administered, the right to delegate health care decisions was recognized relatively recently. On December 18, 1990, an act allowing a durable power of attorney for health care, also called a Health Care Proxy, became law. The Health Care Proxy allows one individual to appoint another to make health care decisions if he or she is unable to communicate with health care providers.

A Living Will is a document that allows one's doctors to forego heroic measures in the event of terminal illness or injury. The Health Care Proxy does not eliminate the need for a Living Will as the Health Care Proxy includes only minimal language relating to the withholding or withdrawal of life sustaining treatment. Thus, an individual who wishes to be covered in this area should sign both a Living Will and a Health Care Proxy.

5. FOR A MARRIED COUPLE, THE COMMUNITY SPOUSE MAY KEEP \$109,560 IN 2009.

Individuals are allowed \$2,000 in countable assets plus an unlimited amount of non-countable assets (see paragraph 8 below). If assets exceed the allowed amounts, the following options might be considered.

6. IF MARRIED, WITH NURSING HOME PLACEMENT FOR THE ILL SPOUSE IN THE DISTANT FUTURE:

A. THE ILL SPOUSE SHOULD TRANSFER ALL OF HIS OR HER INTEREST IN THE ASSETS TO THE WELL SPOUSE AND, IF POSSIBLE, ASSIGN ALL OF HIS OR HER INTERESTS IN INCOME TO THE WELL SPOUSE.

Transfers between spouses are not disqualifying because the assets of both husband and wife are aggregated at the time an individual is admitted to a long term health care facility. However, the income of the well spouse is not deemed available to the ill spouse. After the initial transfer of assets from ill spouse to well spouse, the well spouse will have all income from marital assets allocated to him or her and, in addition, may have the flexibility to consider making additional transfers as discussed below.

B. IF THE ILL SPOUSE IS BEING CARED FOR AT HOME, CONSIDER APPLYING FOR COMMUNITY MEDICAID (MASSHEALTH) UNDER THE FRAIL ELDER RULES.

If the ill spouse's income is less than \$2,022 per month (300% of the federal benefit rate/\$674 for 2009) and the countable assets in his or her name alone (not including the spouse's assets) are \$2,000 or less, it may be possible to receive community based Medicaid, i.e., medical services provided in the home. The ill spouse must be evaluated and determined to qualify medically as needing the level of care provided in a nursing home. Because there is no prohibition on transfers between spouses, the well spouse can hold all of the couple's countable assets. Furthermore, having a community based Medicaid card under the MassHealth program can ease the Medicaid application process should the elder later enter a nursing home.

C. IF THERE ARE SUFFICIENT ASSETS AND NURSING HOME PLACEMENT IS MORE THAN 5 YEARS AWAY, CONSIDER TRANSFERS TO OTHER FAMILY MEMBERS OR TRANSFERS OF ASSETS INTO INCOME-ONLY GRANTOR TRUSTS. NOTE: YOUR ATTORNEY MUST ADVISE YOU NOT TO APPLY FOR MEDICAID WITHIN THE TRANSFER DISQUALIFICATION PERIOD.

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1. Outright Transfers. Outright transfers to family members may remove assets from consideration for Medicaid eligibility purposes but will generate a benefit disqualification period if made within the 60 months prior to the date on which the disabled individual would have been eligible but for the transfers (see paragraph 9). The transferor must relinquish complete control over the property and any income it produces unless the transfer is to an income-only trust, in which case the income and the right to use the property may be preserved (see paragraph 2.c. below). Note, however, that assets transferred to an individual are vulnerable to claims of that individual's creditors.

 2. Transfers with Retained Interests. If the transferred property is a home, consider retaining a life estate in the deed, making the transfer subject to a separate occupancy agreement or transferring the property to an Income Only Grantor Trust. Property will remain in the transferor's estate for federal estate tax purposes.
 - a. Life Estate. A transfer with a retained life estate will protect the property from claims of the transferee's creditors and has the added benefit of allowing the home to pass to the transferor's heirs with a stepped-up basis for capital gains tax purposes if the transferor dies owning the home. (See Note, below.) If the home is sold while the transferor is living, the election to exclude \$250,000 of sale proceeds (\$500,000 for a couple) from capital gains tax will only be available to the portion attributable to the value of the life estate. If the life tenant is receiving Medicaid, the sale proceeds allocable to him or her must be used to reimburse the state for benefits received to date if there is a Medicaid lien on the life tenant's interest.

 - b. Occupancy Agreement. A transfer subject to a right of occupancy under a written agreement allows the property to pass to heirs with a stepped-up basis (see Note, below) but eliminates the \$250,000 (\$500,000 for a couple) exclusion from capital gains tax. It has the advantage of completely removing the home from consideration for purposes of Medicaid eligibility but the disadvantage of leaving the home subject to claims by the transferee's creditors and to capital gains tax upon sale.
- Note:** Assets conveyed subject to a retained life estate or an occupancy agreement may not qualify for a stepped-up basis in the year 2010 and possibly thereafter if Congress extends repeal of the estate tax beyond that year.
- c. Transfers to Income Only Grantor Trusts. Carefully drafted income-only trusts have become the vehicle of choice under the new DRA rules. If the applicant's or spouse's interest is restricted to income only, with no access to principal, after a disqualification of 60 months, the principal would not be considered for purposes of Medicaid eligibility.

If properly drafted, these trusts provide the following benefits:

- Most homes can be sold capital gains tax free under the homeowner tax benefit rules discussed above. This is because the trust is considered a "grantor" trust, and the grantor is treated as the owner of the home for income tax purposes.
- Replacement property can be purchased by the trust and the grantor may continue to enjoy the use of the property,
- If rental property is purchased by the trust, the rental income generated is paid to the grantor.
- If sale proceeds of the home are invested, the grantor receives the investment income.
- If the grantor so directs in the trust instrument, children may have access to principal.

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- During the lifetime of the grantor, the children's creditors have no access to the property.
- Upon the death of the grantor, the grantor can designate trust beneficiaries who receive the property with a tax basis equal to the property's fair market value on the date of the grantor's death. (See Note above.)

D. IF ECONOMICALLY FEASIBLE, CONSIDER LONG TERM CARE INSURANCE FOR BOTH SPOUSES, IF BOTH QUALIFY, OR AT LEAST FOR THE WELL SPOUSE.

This coverage becomes critical as federal and state long term care benefits are curtailed, but policies must be purchased before the onset of illness. Be sure to shop with a reputable broker selling products from several different companies. Sometimes it makes sense to plan to pay for the policy only during the 5 year disqualification period after transfer of assets by the insured. Be sure each policy considered contains an inflation adjustment (if purchasers are relatively young) and covers both nursing home and in-home care based on a need in any one of the following areas:

1. Assistance with activities of daily living (two or more); or
2. Mental confusion or incompetence.

To protect the home from estate recovery, coverage remaining in the policy at the time an individual enters a nursing home must be the equivalent of at least \$125 a day for 2 years. Policies with benefits in excess of this amount are recommended in order to cover a period of home care.

Part or all of premiums for contracts that are within certain limits are deductible as a medical expense (subject to a 7.5% floor) against federal income tax. In addition, if the policy is tax qualified, benefits are tax-free.

If the cost of a long-term care policy is prohibitive, family members might consider purchasing the policy and paying the premiums on behalf of the elder. This allows the elder to gift other assets, perhaps stocks or real estate, and wait out the five-year look back period.

E. BEFORE OR IMMEDIATELY AFTER ANY TRANSFER OF ASSETS TO THE WELL SPOUSE, THE WELL SPOUSE SHOULD EXECUTE A WILL AND POSSIBLY A TRUST.

The Will should designate all the well spouse's assets to the couple's children or to a trust that would benefit the ill spouse in a way that would not result in his or her disqualification for Medicaid or other benefits. These trusts are coming under increasing scrutiny and should be drafted carefully with current developments in mind. If the trust is intervivos, the trust must not be funded while the ill spouse is living. Many practitioners are using testamentary trusts instead of intervivos ones to insure that the trust property for the benefit of the ill spouse is protected in the event the family moves to another jurisdiction which does not respect intervivos trusts.

7. IF MARRIED, WITH NURSING HOME CARE IMMINENT, IN ADDITION TO THE STEPS DESCRIBED IN PARAGRAPH 6, ABOVE, SPEND DOWN EXCESS ASSETS AS PROVIDED IN PARAGRAPH 8, BELOW.

8. UPON ADMISSION TO A NURSING HOME.

- A. Consider Purchasing "Non-Countable" Assets with Excess Funds.

Non-countable assets are not calculated in the asset limits specified in Paragraph 5, above.

In Massachusetts non-countable assets include:

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1. Principal residence with an equity value of \$750,000, unless owner does not intend to return home and none of the following lives there: spouse, minor or disabled child, sibling with equity interest in the home for one (1) year or more, caregiver child who has lived in the home for 2 years;
2. For a couple, one (1) car of any value if necessary for employment, medical treatment, transportation of the handicapped, etc; for an individual, a car with equity of \$4,500.00 or less;
3. Burial accounts for individual or both spouses, initial deposit(s) up to \$1,500.00 each account;
4. Pre-paid funeral contracts or irrevocable burial trust for individual or both spouses;
5. Monument and burial plot for individual or both spouses;
6. Personal property, such as clothing, furniture, television etc.;
7. Whole life insurance with a face value equal to or less than \$1,500.00; term life insurance of any amount;
8. Business or rental property;

All other assets are countable assets.

B. Make Needed Repairs/Improvements in the Home.

These can include roof repairs, furnace repairs, painting, driveway repairs, lawn or garden work, adding to or improving the existing building.

C. Pay Off Existing Debts.

If there is a mortgage on the home or other debts, pay the balance from excess funds.

D. Prepay income and/or property taxes.

E. Consider purchase of and interest in a home or income producing property.

This may be one of the better options currently available.

Note that the purchase of a life estate interest in a child's home is now considered as a disqualifying transfer unless the elder resides in the home for one year.

F. If income is low, consult an attorney about the possibility of retaining part or all of excess assets.

If, after application for Medicaid, the community spouse can show that he or she needs to retain assets to generate income necessary to provide for basic support (the minimum spousal income allowance, set every July 1, is currently \$1,822.00 per month as of July 1, 2009; the maximum, set on January 1 each year is \$2,739 for 2009). The income allowance can be increased if the community spouse has extraordinary needs. The applicant may request that the community spouse be allowed to retain excess assets. Such requests must be granted to the extent necessary to bring the community

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spouse up to minimum income levels, however, an administrative hearing is required.

G. Consider Purchasing an Annuity for the Well Spouse with Excess Assets.

Such a purchase converts countable assets, such as cash and stock, into an income stream for the benefit of the community spouse and this planning opportunity is still available under DRA. (See **Note** below.) With the purchase of a properly structured annuity, all or most of the couple's assets may still be preserved for the benefit of the well spouse. **Caution:** The annuity term must not exceed the life expectancy of the well spouse or a disqualifying transfer will be deemed to have occurred. Life expectancy is determined under new tables promulgated by the federal agency formerly known as the Health Care Financing Administration (now the Center for Medicare and Medicaid Services). The annuity should be reviewed by an attorney knowledgeable about current Medicaid regulation and practices in this area as there are many technical requirements which must be met, and the annuity area is coming under increasing scrutiny by the government. **Do not purchase an annuity until the ill spouse is about to enter or has been placed in nursing home.**

Note: There is some uncertainty as to whether the state must be named as the beneficiary of the well spouse's annuity to the extent of any benefits provided the ill spouse. Most practitioners do not believe this should be an issue, but judgment should be reserved until Massachusetts regulations have been interpreted by administrative and judicial decisions. For planning purposes, it makes sense to structure such an annuity for as short a term as reasonably possible so as to minimize the possibility of the state receiving benefits upon the death of the spouse, so name the children or other individuals as beneficiaries and be prepared to insert the state if later required to do so.

H. Consider Establishing and Prepaying and Continuing Care Contract with Family Members Who Provide Care to the Elder.

Note that personal care contracts are being challenged by the Division and a number of court cases are pending. If allowed, the payment is taxable income to the caretaker. The amount should be based on the life expectancy of the elder under the new CMS tables.

9. CONSIDER CAREFULLY STRUCTURED TRANSFERS TO FAMILY MEMBERS.

The most draconian aspects of DRA are illustrated by the following two changes in the transfer disqualification rules:

- A. Look back Period for Transfers. For purposes of Medicaid eligibility, all transfers made in the last five (5) years prior to the application for medical assistance will be considered. In the past, this "look-back" period was three (3) years for transfers to individuals and five (5) years for transfers to trusts.
- B. Disqualification Start Date. The start of the disqualification period for transfers made within the prior five (5) years begins on the date when the individual transferring the asset (or his or her spouse) enters the nursing home and would otherwise be eligible for medical assistance but for the transfer disqualification. It appears that the government may interpret "medical assistance" to mean "medical payment" which would not be required until all other sources of payment, i.e., annuities, loans, gift backs, etc., have been exhausted. In the past, the penalty period started on the first day of the month in which the transfer was made. Now, an individual who transfers funds within five (5) years of entering a nursing home and applying for Medicaid would remain ineligible for Medicaid even though he or she has

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no funds available to pay the ensuing nursing home bill. The length of the ineligibility period would vary based on how much was transferred in the past.

In spite of this, planning opportunities remain. Because of the lack of court guidance interpreting these regulations, we cannot say with certainty what kind of transfers are acceptable under the new law. When the law first passed, it had appeared that a transfer could be made of part of the elder's assets with the remaining reconfigured into income property, perhaps in the form of a specifically drafted annuity or loan, to cover the elder's expenses during the ensuing disqualification period. Recently, however, indications have been to the contrary. Because of the ongoing and rapid developments on this front, it is critical to consult with a knowledgeable attorney in order to structure a plan that is right for you.

- C. Joint Purchase of Home or Investment Property. Such joint purchase with parent and child with joint rights of survivorship may well afford opportunities to spend down excess assets in ways which will serve to pass them to designated beneficiaries outside of probate and free of MassHealth claims. However, these, too, are being challenged by MassHealth. Check with your attorney as to the current status of this planning option.

10. CHECK BACK WITH YOUR ATTORNEY TO UPDATE YOUR FINANCIAL PLAN SHOULD MAJOR CHANGES OCCUR OR LOOM ON THE HORIZON.

Should nursing home placement appear likely, check with your attorney before such placement actually takes place to make sure your assets are arranged in an optimal fashion and to plan the most effective way to spend down excess assets after admission to the nursing home.

11. MAKE SURE THE ADVICE YOU ARE RECEIVING IS CURRENT. The law in this area changes almost hourly. Be sure you have consulted someone who is an expert in the field of Medicaid planning and elder law before you proceed.

12. REMEMBER THAT THERE IS ALMOST ALWAYS SOMETHING THAT YOU CAN DO TO PRESERVE ASSETS, SO DON'T BE AFRAID TO CONSULT WITH A KNOWLEDGEABLE ATTORNEY.

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