PLANNING WITH MEDICAID ANNUITIES

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When a loved one requires 24/7 skilled nursing care, selecting the best facility can be confusing and stressful. Factors for consideration include whether the facility has great dementia programming, the rate of staff turnover, and the period of private pay required, and of course, the client's liquid resources.

Frequently, clients ask me how to pay for their care. Financing long-term care is an important, practical consideration, but it should not be the tail which wages the dog. The first priority must be to select the best care available, for peace of mind. Fortunately, using a Medicaid compliant annuity can be an option to qualify for Medicaid and help a healthy spouse who will continue to reside in the community to pay for their own housing and living costs, without the institutionalized spouse's income, which may be required to be paid over to the long-term care facility. How does this strategy work?

John and Mary Doe are our hypothetical clients. John is eighty-two years old, and suffers from Alzheimer's dementia. John was recently hospitalized due to a fall, and will not be able to return to live in the marital home with Mary. Mary has learned that John will need skilled nursing care at a private pay cost of over $9,000.00 per month. She is worried about how to pay for that care.

Mary is seventy-nine years old, and is healthier than John. Mary still lives in the former marital home. Her income is from Social Security and is only about $670.90 gross per month. This is not sufficient for Mary to live on in the community. Also, Mary is declining, and may herself require assisted living. Whether she remains at home or not, she will need John's monthly income, which is only about $2,000.00. How are Mary and John going to pay for the care John needs and any future care for Mary?

When Mary comes to you, she and John have approximately $430,000.00 in countable assets, not including their home. As the community spouse, Mary can keep up to $121,220.00 of the couple's resources, in order for John to qualify financially for Medicaid. If Mary and John have countable resources (i.e, liquid assets such as savings, checking and certificate of deposit accounts, stocks, bonds and life insurance with any cash surrender value), above that level, John will not qualify for Medicaid.

Mary has a choice. She can either spend all of the couple's assets on John's care until she is left with well less than $121,200.00, at which point, John may become eligible for Medicaid to pay for his skilled nursing care. Alternatively, Mary can purchase a Medicaid compliant spousal annuity for up to $310,000.00 ($430,000.00 less $121,220.00 = $308,790), and this annuity will provide her with additional monthly income of over $8,600.00 over a term of three years. Note that by purchasing the annuity for $310,000 instead of $308,790.00, we have created a small buffer to spend Mary and John well below the spousal maximum of $121,200.00, in case they have any assets of which they are unaware or the market value of their assets rise.

If the annuity is Medicaid-compliant, then it will cannot be treated as a countable asset, and after its purchase, Mary and John now have only $120,000.00 in countable resources, which means that John is financially eligible for Medicaid. Remember that Mary will be receiving the sum of over $8,600.00 for three years in addition to her own Social Security. If Mary requires assisted living, she will now have ample funds to pay for that care until she herself can become eligible for Medicaid.

What are the drawbacks of a Medicaid-compliant annuity? Successfully using a Medicaid compliant annuity requires patience and perseverance. Due to the State of New Jersey's current policies and procedures, litigation in federal court may sometimes be required, so this technique is not suitable for the faint of heart. There are strictly construed legal requirements which must be met, in order for the annuity to be determined Medicaid-compliant, which are discussed below. If the annuity is not a Medicaid individual retirement annuity, the State of New Jersey must be named as the first remainder beneficiary to the extent of any Medicaid benefits for John. This means that if Mary dies before John, some of the principal remaining on the annuity will need to be paid over to the State. (The rest can pass to Mary's beneficiaries, which are likely her children.) Also, the funds invested in the annuity cannot be accessed, the monthly payments on the annuity must be equal in amount, and the annuity's rate of return is generally low. The annuity cannot be assigned or revoked. However, once the applicant becomes Medicaid-eligible, the spouse may keep all of the income from the annuity.

At this time, using annuities which meet the requirements of the Deficit Reduction Act of 2005 remains viable planning strategy in the wake of a Third Circuit Court of Appeals in *Weatherbee v. Richman, 595 F. Supp. 2d 607 (W.D.Pa.2008), aff'd, 351 Fed. Appx. 786 (3d Cir. 2009)* and the express language of the Deficit Reduction Act of 2005, which treats the monthly payments from the annuity as an income stream, rather than a countable asset. Medicaid annuity planning is also supported by a series of recent, unpublished federal district court decisions and administrative decisions in New Jersey and the ruling of the Eighth Circuit Court of Appeals endorsing the use of a DRA-compliant annuity in Geston v. Anderson, (No. 12-2224, September 13, 2013). *See e.g. Carlini v. Velez, 2013 U.S. Dist. LEXIS 78160 (No. 12-7290, June 4, 2013) and Flamini v. Velez, 2013 U.S. Dist. LEXIS 101183 (No. 07304, D.N.J. July 19, 2013); M.W. v. D.M.A.H.S. and Union County Board of Social Services, (OAL Docket No. HMA 2998-2013, January 28, 2014)*.

In Carlini, after the federal court enjoined the State from improper treatment of the DRA-compliant annuity purchased, the County Welfare Office processed the Medicaid application for Mr. Carlini and Medicaid paid for his skilled nursing care.

The Flamini v. Velez decision also validated the purchase by the community spouse, of a DRA-compliant individual retirement annuity. The court further found that the law appears expressly designed to permit this specific type of structuring without threatening to compromise Medicaid eligibility.

Why does Medicaid planning with annuities work? The Social Security statute, the accompanying federal regulations, and the SSI administrative guidelines generally classify the payments from an annuity as income. See *20 C.F.R. § 416.1102; Social Security Administration Program Operations Manual System ("POMS") SI 00810.005.A.1; 20 C.F.R. § 416.1121(a); POMS SI 00810.015.3.d; SI 00830.160.B1.f* .

Under the M*edicare Catastrophic Coverage Act,* the income received by the community spouse cannot impact the Medicaid eligibility of the institutionalized spouse. *42 U.S.C. § 1396r-5(b)(1).*Unless otherwise provided in the instrument, income paid to solely in the name of the community spouse is available only to that spouse. This is true whether the income is from "trust" property or "non-trust" property. *42 U.S.C. §§ 1396r-5(b)(2)(A)(i) and (B)(ii)(i). This means that Mary's post-eligibility income from the annuity does not count towards John's income and Mary may keep this income.*

Note that tax-qualified and non-qualified annuities are treated differently by the Deficit Reduction Act of 2005, and, to be compliant, must be irrevocable and nonassignable, actuarially sound, and must have equal monthly payments during the annuity term, with no deferral and no balloon payments made. The annuity must also name the State of New Jersey as the first remainder beneficiary at least to the extent of any Medicaid lien.

Regarding tax-qualified individual retirement annuities, two basic requirements must be met for the annuity to be a DRA-compliant annuity. First, the annuity must name the State as the remainder beneficiary in the first position at least to the extent of any Medicaid lien. *See 42 U.S.C. §1396p(c)(1)(F)(i).* The second requirement for special treatment as a tax-qualified annuity under the DRA is that the annuity must be a tax-qualified annuity and must be designated within the annuity contract as a tax-qualified annuity under *I.R.C. § 408(b),* or must be funded with the proceeds of an individual retirement account, inter alia. *See 42 U.S.C. § 1396p(c)(1)(G)(i)(I),(II)(aa)-(cc); Treasury Reg. § 20.2039-5* (annuities under individual retirement plans).

Because an individual retirement annuity contract must comply with the stringent provisions of § *408(b)* and the related regulations, an individual retirement annuity contract is irrevocable, non-assignable, non-transferable, actuarially sound and as pays out only equal monthly payments. These attributes are already incorporated by reference into the annuity contract by virtue of its being an individual retirement annuity. A tax-qualified individual retirement annuity subject to the very strict anti-transfer and anti-alienation provisions of the Tax Code and the Treasury Regulations.

A tax-qualified, individual retirement annuity contract must also meet the federal Internal Revenue Service test of substantially equal payments. In other words, the annuity cannot have any provision for a withdrawal right or an advance payment rider. Any such provision must be well below the forty per cent limit on lump sum withdrawals contained in T.R. § 20.2039-5(b) for the annuity to be a qualifying annuity. So long as the withdrawal right remains well below forty per cent of the policy principal, there will be compliance with the "substantially equal payment" test found in T.R. § 20.2039-5(b) and the annuity is a "qualified individual retirement annuity" within the meaning of Treasury Regulation *§ 20.2039-5*.

The requirements for non-qualified, D.R.A. compliant annuities are more restrictive. In order to be DRA-compliant, non-qualified annuities must be irrevocable and non-assignable, actuarially sound, and which provides for equal monthly payments with no balloon or deferred payments. If an annuity satisfies the requirements of § 1396p (c)(1)(G)(ii), the purchase of this annuity cannot be regarded as an available (and thus countable) resource or an uncompensated transfer of assets by the community spouse, and cannot result in the imposition of any Medicaid penalty period. Section § 1396p(c)(1)(G)(ii) provides, in pertinent part:

(G) For purposes of this paragraph with respect to a transfer of assets, the term "assets" includes an annuity purchased by or on behalf of an annuitant who has applied for medical assistance with respect to nursing facility services or other long-term care services under this subchapter ***unless …***

(ii) the annuity—

(I) is irrevocable and nonassignable;

(II) is actuarially sound (as determined in accordance with actuarial publications of the Office of the Chief Actuary of the Social Security Administration); and

(III) provides for payments in equal amounts during the term of the annuity, with no deferral and no balloon payments made.

In conclusion, if all of the requirements discussed above are met, using a Medicaid annuity can be an effective asset protection planning strategy for the risk-tolerant client.

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This article reflects the opinions of the author and not necessarily those of EFPC of SNJ.