Screwed

Federal government tells elderly and disabled to go pay for their own care. Courts remain more judicious

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Asset protection is at the core of many elder law practices. Rising healthcare costs and the harrowing cost of long-term care are a growing concern—even for the wealthy. Even great family fortunes can be compromised by unforeseen medical expenses—not only for the elderly in need of nursing care, but also for younger, disabled relatives who may need decades of extraordinary assistance.

A lot of people mistakenly believe that Medicare will help pay for the cost of such care if it's needed. This misconception deters many from purchasing adequate long-term care insurance. Then a crisis hits—maybe it's a birth defect, Parkinson's disease, Alzheimer's, a heart attack or stroke—and families are forced to pay out-of-pocket or to turn to the federal Medicaid program. Unlike Medicare, which allows for automatic eligibility upon turning age 65, Medicaid is a means-tested program, with increasingly unreachable eligibility standards. These developments have an adverse impact on clients in every socio-economic class.

All advisors, even those serving the fabulously rich, need to be aware that 2006 was a tumultuous year for Medicaid. Of course, the biggest news was the Deficit Reduction Act of 2005 (DRA), signed into law on Feb. 8, 2006. This was the first significant change in federal Medicaid law since the Omnibus Budget Reconciliation Act of 1993 (OBRA).[1] The Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services, in Baltimore, published guidelines on July 27, 2006, for state Medicaid directors to help them interpret and implement the DRA. But the sad fact is that the CMS guidelines offered little direction and even fewer details. To a large extent, these guidelines merely recite DRA's statutory language leaving implementation to the uncertain powers of the state Medicaid agencies.

Although Medicaid is abandoning countless seniors and disabled people, a recent slew of decisions shows that the courts are more carefully balancing the desire to control public spending with the need to provide healthcare for citizens.

THE DRA

As its name implies, the DRA was designed to trim federal expenditures and cut the federal deficit. Many of these reductions will fall squarely on the backs of vulnerable elders and disabled youngsters. At the same time, the DRA represents a clear victory for and endorsement of the private sector in the form of the long-term care insurance industry. In addition to making Medicaid eligibility less attainable, the DRA explicitly, and in detail, calls for the expansion of State Partnership Long-Term Care Insurance Programs, which—before the DRA—existed in only four states: California, Connecticut, Indiana and New York.

Here are the highlights of the DRA changes in Medicaid law:

• **Look-back period**—The "look-back period" was extended to 60 months from 36 months. This means that Medicaid applications will ask about any asset transfers made within the prior five years instead of the prior three years. Several states have opted to phase-in the look-back from 36 to 60 months one month at a time, start-

ing in February 2009. Others are applying the 60-month look-back immediately.

• **Ineligibility start date**—The commencement date of the period of ineligibility (attributable to a gift) is changed for gifts made on or after Feb. 8, 2006. Pre-DRA law stated that the period of ineligibility that flowed from a gift started on the date of the gift. Therefore, a small gift of perhaps $20,000 made one year ago did not adversely affect eligibility, because the period of Medicaid ineligibility typically would have been between three and five months. If the period began on the date of the gift, then the period of ineligibility would end more than six months before the new Medicaid application is filed, long before the individual is in a nursing home. Under the DRA, the period of ineligibility (calculated in the same manner) does not start until the elder is in the nursing home, applies for Medicaid, and can show that she is eligible for Medicaid (that is to say that she's virtually penniless) but for the earlier gift. If that gift generates a five-month period of ineligibility, she'll be ineligible for the next five months, during which time she has no money to pay the cost of her nursing home care and Medicaid is denied. Meanwhile, the nursing home has no source of reimbursement. Because of these potentially catastrophic circumstances, it is incumbent on advisors to counsel their clients to plan further in advance.

• **Caps**—A cap was placed on the value of an exempt residence. Previously, a residence of any value was exempt and was not counted in determining eligibility. Under the DRA, for applications filed on or after Jan. 1, 2006, a residence with an equity interest (that is to say, market value less debt) greater than $500,000 presents a barrier to eligibility. States have the option of increasing this cap to any amount up to $750,000—as some states have chosen to do.

• **Annuities**—Annuities still are allowed in limited circumstances, but the state Medicaid program must be named as either the primary or secondary beneficiary of the annuity. The goal is to enhance the likelihood that the state will obtain reimbursement for Medicaid dollars devoted to the care of an elderly or disabled person.

The DRA will make many elders ineligible for Medicaid.

• **Insurance**—State long-term care partnership (long-term care insurance) plans receive a significant boost. Partnership plans offer a dollar-for-dollar inducement to purchase long-term care insurance. For example, a $100,000 long-term care insurance policy will allow an individual to preserve $100,000 in assets while qualifying for Medicaid. So far, about 22 states have filed for approval of these plans. The DRA calls for the expansion of partnership plans to all states and calls for the development of uniform standards to enhance the likelihood that purchased long-term care insurance partnership plans will be portable among the states.

The DRA will prohibit many elders who otherwise would have achieved Medicaid eligibility from doing so.

Conversely, there are many asset transfers that remain available without the imposition of any penalty period whatsoever. These include certain transfers to a spouse or a child with disabilities. In addition, the residence may be transferred, without penalty, to two very important categories of people: a sibling who has an equity interest in the residence and has lived there for at least a year, or a child who has been a caregiver and lived in the home for at least two years before the parent enters a nursing home (provided that the child served as the caregiver for the parent and kept the parent out of a nursing home for that two-year period). Under such circumstances, the caregiver must document the care that was given.

Importantly, the DRA does not change everything. It is a scalpel, not a sledge hammer. Many provisions of pre-DRA law remain intact and unaffected and are contained in the Medicaid provisions of OBRA.

CASE LAW

Last year, the courts also addressed a number asset transfer matters critical to elder and disability law:

• **Failure to elect constitutes transfer of assets**—A New Jersey appeals court, for example, dealt with an institutionalized spouse whose husband died. She failed to elect against her husband's will, thereby allowing the estate to pass to a testamentary trust he had established for her benefit. This failure to elect, conceptually akin to not accessing assets to which a spouse is otherwise entitled, was deemed a transfer of assets and resulted in Medicaid ineligibility.[2]

• **Personal service contracts**—Two other important cases dealt with asset transfers in the context of personal care contracts. Increasingly, caregiving children are entering into contractual relationships with their parent(s). Rather than provide uncompensated care for months or years, children enter into contracts describing the type of care to be provided and the financial compensation for this care. These arrangements acknowledge the devotion and sacrifice made by

the caregiving child, while compensating for reductions in home health payments under Medicaid. They address inequities that flow from the typical situation in which a child (typically a daughter) moves back home to care for mom and keep her out of an expensive nursing home or assisted living facility. The other siblings do nothing and often benefit substantially from the sacrifices of their sibling. Caregiving contracts make sense because assets conveyed from parent to child are not transfers for less than the fair market value of the caregiving services. If properly structured, such arrangements do not generate periods of Medicaid ineligibility.

At least two courts came to this conclusion during the past year. A Missouri appeals court reviewed a situation in which an institutionalized parent transferred assets to her daughter who was to provide personal care services while her mother was in the facility. This was deemed fair compensation based on the terms of their particular agreement. The transfer did not defer or deter Medicaid eligibility.[3]

A Louisiana appeals court came to a similar conclusion. In *Carpenter v. State*,[4] a significant lump-sum payment was made to a child pursuant to the terms of a personal services agreement. Upon review, the court found that the terms were fair and that there was an arms-length exchange of services for funds. The daughter had to pay income tax for the funds received, as is the case with all personal services contracts.

As asset transfer rules become stricter, we expect personal service contracts to emerge and to become a legitimate means of preserving family assets, especially among wealthy families. Of course, when drafting these agreements, it is important to address the tax considerations so that the assets are not consumed by taxes. At the same time, you also want to ensure that the parents' assets are divided fairly among the children. For instance, if you have three daughters and the eldest daughter takes care of the father by taking him to doctor's appointments and by attending to some of his medical needs, that daughter may be compensated through a personal service contract. When the father dies, however, each of the daughters would receive a fair (and perhaps equal) share of the father's assets.

SNTS

Meanwhile, special needs trusts (SNTs) are increasingly common, both because of increased incidents of disability (think of the increasing rate of diagnosed autism) and because practitioners are more aware of the benefits of special needs trusts. An SNT holds assets for the benefit of an individual with disabilities who is receiving public benefits, such as Supplemental Security Income (SSI) or Medicaid. These trusts are particularly important for the wealthy because they may have so much to protect. Regardless of how opulent the trust, eligibility is not adversely affected because of proscriptive trust language denying the trustee the right to utilize trust assets to pay for goods or services provided by the public benefits system.

It can be troubling when an individual with disabilities inherits money, receives money by way of gift, or obtains a settlement in court actions such as personal injury, because unless such assets are placed in an SNT, public benefits eligibility is lost.

A recent California Court of Appeals decision is very helpful in this regard. In *Conservatorship of the Estate of Kane*,[5] the court held that a probate court could establish an SNT in reliance on the concept of substituted judgment under California law. A developmentally disabled adult had disqualifying resources, but had no parent or grandparent who could create such a trust and transfer the individual's assets into it. Under such circumstances, it is appropriate for a probate court to establish and fund an SNT.

In another case involving special needs trusts, the U.S. Supreme Court held that a Medicaid program's lien against a personal injury settlement is limited by federal law to the amount of the settlement attributable to the beneficiary's medical expenses.[6]

The Supreme Court, in upholding the Eighth Circuit, reasoned that the Social Security Act required state law to create an assignment only of the recipient's claims for medical expenses. Contrary to Medicaid's assertion, federal law did not mandate a lien against any property of the recipient other than the claim for payment of medical expenses.

KEEP IN MIND

The Supreme Court case brings to mind other case developments in 2006 important to elder and disability law:

- **A Serbian bog**—One of our favorite cases over the past year is Missouri's *Hutchings v. Roling*.[7] An accomplished attorney ventured into the world of Medicaid waiver determinations and successfully pursued an appeal. Medicaid waivers allow states to experiment with their Medicaid dollars and to develop new programs. They generally are designed to make a program more efficient and effective. In fact, waivers are often used to restrict services and restrain budgets. In determining that the attorney was entitled to an enhanced hourly fee for his successful work, the court referred to the Medicaid program as a "Serbonian bog." We could not agree more.[8]
- **Spousal refusal**—In *Morenz v. Wilson-Coker*,[9] the U.S. Court of Appeals for the Second Circuit

affirmed a lower court holding that the assets of a community spouse who executes a "spousal refusal" may not be counted in determining the Medicaid eligibility of the ill spouse. The relevant federal Medicaid statute, 42 U.S.C. Section 1396r-5(c)(2) describes how Medicaid must deal with the community spouse's assets. Under that section, the community spouse's assets are not considered available to the Medicaid applicant if the applicant has assigned his support rights to the state, or if the state determines that denial of eligibility would result in an undue hardship.

Noting the ambiguity of the statutory language, the Second Circuit upheld a Connecticut district court's holding that the community spouse's resources could not be considered by Medicaid. The court noted that the Department of Social Services interpretation was inconsistent with the federal Medicaid laws. Thus, given the plain language of the statute, the court deferred to the nearly identical federal agency interpretation over the inconsistent state interpretation.

Federal Medicaid law provides a special, protective opportunity to spouses when facing the relentless cost of nursing home care. A community spouse (the spouse living at home) may refuse to use her assets to pay the cost of care for her institutionalized husband. A prerequisite is that the institutionalized spouse assigns his right of collection or right of support against the "refusing spouse" to the state. In some cases, the state Medicaid program rather aggressively pursues collection against the refusing spouse pursuant to this assigned right of support.

- **Attorney-authorized gifts**—For estate-planning and Medicaid-planning purposes, transfers of assets are not uncommon. Durable powers of attorney may explicitly authorize such gifting, even to the agent, the attorney-in-fact. New York's highest court recently determined that such gifts must be in the principal's best interest and that such transfers must be consistent with the principal's overall estate plan.[10]

- **Expertise matters**—Many times we've heard: "Any attorney can draft a simple will." The question is, should any attorney do it? A District of Columbia attorney thought he was doing a favor for friends when he drafted a will, even though he had no estate-planning experience. Not only was he found to have incompetently drafted the documents and represented his friend (client), he also was found to have engaged in a conflict of interest because of his presence in the estate plan. The attorney received a 30-day suspension. (We all need to see a case like this once in a while.)

LOOKING AHEAD

Legislative developments have not been kind to middle-class and lower-income elders. Also caught in the fray are the wealthy, who have a lot to protect and a great deal to lose. The DRA was particularly onerous in placing enormous burdens on the elderly in efforts to restrict federal expenditures. Fortunately, in several instances, the courts have somewhat leveled the playing field. There's hope that the new Democratic Congress might repeal the most onerous provisions of the DRA. ❙

Endnotes

1. For an extensive discussion of the Deficit Reduction Act, *see* Michael Gilfix and Bernard A. Krooks, "Throw Mama from the Train," *Trusts & Estates*, March 2006, at p. 36.
2. *I.G. v Department of Human Services*, No. A-0006-05T5 (N.J. Super. Ct. App. Div. June 13, 2006).
3. *Reed v. Missouri Department of Social Services*, ED 87348 (Mo. Ct. App. June 20, 2006).
4. La. Ct. App., No. 2005 CA 1904 (Sept. 20, 2006).
5. No. A110631 (Cal. Ct. App. March 6, 2006).
6. *Arkansas Dep't of Health & Human Servs. v. Ahlborn*, 126 S.Ct. 1752 (2006).
7. Nos. ED 85999 and ED 86019 (Mo. Ct. App. April 4, 2006).
8. A "Serbonian bog" is a quagmire, named after the lake of Serbonis in Egypt, which, because of the sand blowing over it, has the deceptive appearance of being solid land. According to the poet John Milton, it is a bog in which entire armies have sunk.
9. Docket No. 04-4107-cv (2d Cir. July 14, 2005).
10. *In the matter of Ferrara*, No. 05156, slip op. (N.Y. Ct. App. June 29, 2006).

SPOTLIGHT

Rich Color, Rich Price—Pablo Picasso's "Plant de tomates" (1944) was auctioned at Christie's "Impressionist and Modern Art Evening Sale" on Nov. 8, 2006 in New York City. It was estimated to garner between $5 million to $7 million; final price was almost double, at $13.456 million.