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States Crack Down on Medicaid Planning

Many states are cracking down on a popular estate planning technique that helps the elderly qualify for Medicaid by using an annuity to convert assets into a protected income stream, experts tell Lawyers Weekly USA.

The technique has become more common in recent years as the nursing home population swells and the elderly seek ways to limit the cost by qualifying for Medicaid.

Estate planning and elder law attorneys say that "Medicaid annuities" are allowed under a 1993 rule published by the Health Care Finance Administration (HCFA) pursuant to the Omnibus Budget Reconciliation Act.

But many states claim such annuities are improper transfers and have recently become aggressive about denying Medicaid funds in cases where an annuity helps reduce the applicant's assets in order to qualify.

"States want to protect their Medicaid dollars, especially since their budgets are in bad shape," says A. Frank Johns of Greensboro, N.C., president of the National Association of Elder Law Attorneys (NAELA).

"In most states you can still use Medicaid annuities, but some states are cracking down. It's new and developing," says Harry Margolis, a Boston elder law attorney.

"It was a common tool before, but in the past year things have changed," says Thomas Begley, an elder law attorney in Moorestown, N.J.

As a result, in some states the technique should no longer be used at all, lawyers say.

Some attorneys are preparing legal challenges.

Michael Millonig, an elder law attorney in Dayton, Ohio, is filing a declaratory judgment action seeking to enjoin the state from denying Medicaid benefits to a client who purchased a $75,000 annuity to qualify for Medicaid.

In addition, many lawyers interviewed for this article complain that some insurance agents continue to market these annuities without being aware of the legal requirements or the recent state crackdown.

These attorneys predict that a number of suits will be filed over annuities sold with the promise of helping the applicant qualify for Medicaid that didn't deliver, either because they weren't properly structured or because the state changed its rules.

How the Annuities Work

In order to qualify for Medicaid in most states the spouse going into a nursing home is allowed to keep only $2,000 of "countable assets." Any income becomes payable to the nursing home.

In most states, the healthy spouse can keep half of the couple's total assets, but no more than $87,000. This is called the "Community Spouse Resource Allocation" (CSRA).

Items such as homes and cars are exempt.

However, there is no limit on the healthy spouse's income, and it is not counted for purposes of determining the other spouse's eligibility for Medicaid.

Therefore, if a couple has $100,000 in assets when the husband moves to a nursing home, Medicaid allows him to keep $2,000 while the wife keeps $50,000.

But by purchasing an annuity with the excess $48,000, the husband can transform his assets into an income stream for his wife, which isn't counted.

Elder law attorneys insist that this technique gets the green light from HCFA's "Transmittal No. 64" as long as the annuity meets certain requirements.

First, the annuity must be for a term certain - a guaranteed number of years.

Second, the annuity must be "actuarially sound." This means it must pay back all of the money within the life expectancy of the annuitant, based on federal tables.

The annuitant's children can't benefit during his or her life, but they can be the remainder beneficiaries, says Johns.

The underlying money also can't be accessible to the Medicaid recipient, and the stream of income must flow out either to him or the healthy spouse, he notes.

Further, the annuity must be immediate, irrevocable and nonassignable.

"You pick the number of months, payments and beneficiaries, and you can't change anything. Everything is in concrete," says Dale Krause, an attorney in De Pere, Wis., who recently spoke at a symposium on this topic.

One risk for married couples using a Medicaid annuity is that if the healthy spouse also ends up in a nursing home, the income will be used to pay for her care.

Medicaid annuities can also be used for single nursing home patients, but they tend to be less popular because they're only useful if the patient dies before his or her life expectancy.

This is because the income stream from the annuity will be used to pay for the patient's care, along with any other income such as social security.

"If [people] live [to] their life expectancy, they've gained nothing through the use of the annuity," explains Craig Reaves of Kansas City, Mo., a member of the NAELA board of directors.

"The gamble is that you'll die before the table says you're supposed to. It's a 'bet to die' strategy, and people don't like to bet to die," says Bernard Krooks, a New York attorney and president-elect of NAELA.

Lawyers says it's also important that an annuity not be purchased too far in advance of the expected need, because the income could pile up and push a person over the eligibility limits by the time he or she applies for Medicaid.

What States Are Doing

State administrators complain that if elder law attorneys are interpreting the HCFA rule properly, the technique would allow even the richest people to qualify for Medicaid.

"If it's an exception, it swallows the whole rule. They could be millionaires and still qualify for Medicaid as long as they put all the excess into an 'actuarially sound annuity,'" says Lynn Wilson, a deputy attorney general in Delaware.

States arguably have some discretion in interpreting the federal rules because Medicaid is jointly funded. Recently, they have taken a variety of measures to curb the use of these annuities.

Here are some of the recent changes:

Treat Annuity As a Transfer

Many state Medicaid agencies have begun treating annuities as transfers.

This triggers a period during which the applicant is ineligible for Medicaid based on the amount of the annuity and the monthly cost of the nursing home.

This has virtually halted the use of Medicaid annuities in those states.

For example, "Kansas says that when you put money into an annuity, it's a transfer. I think they're wrong, but it costs a lot of money to litigate. If I lose, my clients are in a position where their money is licked up in an annuity, they can't get it out and it's disqualifying them," says Reaves.

Harrisburg, Pa., estate planning and tax attorney David Haller says that his state's Medicaid agency has recently changed its policies to treat annuities as transfers subject to an ineligibility period.

"I won't suggest an annuity without clearly outlining what all the choices are and the suggested outcome. I almost always try to talk [clients] into another method," he says.

Ban Balloon Payments

Some Medicaid annuities don't pay out the same amount every month. Instead, they pay out a smaller amount for each month and make a "balloon payment" in the final month.

This anticipates that the person will die before the last month and the bulk of the money will go to the children.

Several states, including Arizona, Indiana and Washington, no longer allow balloon payment annuities.

Many lawyers agree that these annuities are abusive. But they say the problem is that seniors have been sold this type of annuity and told that it can be used to qualify for Medicaid later on.

"The insurance industry is selling 'Medicaid friendly' annuities to people who are not yet in a nursing home, and telling them that if the time ever does come to go into a home, they can use the annuity to protect themselves and ultimately qualify for Medicaid. The problem is the states are changing the rules," says Krause.

Many lawyers predict an onslaught of lawsuits, including possibly a class action, as seniors realize the annuities they purchased aren't valid "Medicaid annuities."

Johns is currently pursuing a settlement with Bankers Life for an 82 year-old woman who was forced to pay for a nursing home for two years because the annuity that she was sold was not properly structured.

Actual Life Expectancy Required

Another new rule in some states is that the annuity must use the annuitant's actual life expectancy rather than the life expectancy according to the federal tables.

"Some states say you can still do a Medicaid annuity, but if the doctor says you have a year to live [and] the tables says you have 20, we're going to use the one-year life expectancy," says Begley.

State Must Be Named Beneficiary

Another strategy some states are using is to require that the state be made the annuity beneficiary.

Under OBRA, all states have the right to "estate recovery," which means they can go after anything in the probate estate, including exempt assets, to repay the state's Medicaid costs.

Many states, including California and New Jersey, have adopted expanded definitions of "estate" that include non-probate assets such as joint property, trust property and life estates.

Recently, HCFA said that in those states, this expanded definition includes remainder payments from an annuity.

At least one state, New Jersey, has gone a step further and requires that it be made the annuity beneficiary.

Some other states are considering doing the same. "But it takes legislation," says Reaves. Margolis notes that this will only apply where the annuity is in the name of the Medicaid applicant, because the state probably wouldn't have the authority to recover from the other spouse's "estate."

What to Tell Clients

Clients should be warned about all the downsides of Medicaid annuities, especially now that states are changing the rules.

"The message to lawyers is make sure you review your state rules before advising your client," says Krooks.

This is true even for clients who have already purchased an annuity.

Many lawyers say they are considering suing insurance agents who have sold annuities claiming they would help protect assets.

"In a lot of cases, the annuity is not irrevocable or doesn't have all the proper buzzwords, but it was sold as protecting assets for a nursing home," says Krooks, whose [sic] has clients contemplating a lawsuit for fraud in the inducement.

"It's infuriating. They tell the client, 'If you buy this annuity it will protect you.' Typically it's a deferred annuity. It's flat-out wrong. A deferred annuity won't protect you and there's a huge penalty for cashing in early. Some of the insurance agents don't understand the intricacies of the rules," says Reaves.

The problems have made Medicaid annuities a last resort in many cases.

Alternatives include spending excess assets, purchasing exempt assets, or making gifts to children, lawyers note.

"One simple thing is to spend down the excess by utilizing simple exemptions-buy a car, fix up a roof, get a new furnace, pay off debts," suggests Millonig.

Recent Cases

The issue has just barely surfaced in state appellate courts. Here are a few recent cases:

Delaware. A $53,000 annuity purchased by the healthy spouse was not an improper transfer where the annuity's term was shorter than the annuitant's life expectancy according to federal tables, and where the state Medicaid statute doesn't presume that transfers during the "look back" period are for the intent of qualifying for Medicaid. Dean v. Dept. of Health and Social Services, Del. Super. Ct. No. 00A-05-006 (Dec. 6, 2000.)

Ohio. A spousal annuity trust was an improper transfer for Medicaid purposes because it exceeded the "community spouse resource allowance." McNamara v. Ohio Dept. of Human Services, 744 N.E2d 1216 (2000).

Pennsylvania. The purchase of an irrevocable annuity for $365,000 with joint assets constitutes a transfer for less than fair market value, and therefore the nursing home spouse is ineligible for Medicaid. Dempsey v. Dept. of Public Welfare, 756 A.2d 90 (2000).