



Using Reverse Half-a-Loaf: Findings From the DRA Implementation Survey

Last Updated: 12/29/2007

It has been nearly two years since the Deficit Reduction Act of 2005 (DRA) became law, and in the interim states have begun implementing it. In response, attorneys have had to adjust their practices to deal with the law's new restrictions.

ElderLawAnswers conducted a survey of attorneys and asked a series of questions about what planning techniques were being used in states where the DRA has been implemented. In addition, we talked to several lawyers in various states to get an idea of what is and is not working for them.

We received responses from 130 attorneys in 32 states, including attorneys in 27 states that have implemented the DRA. Among other questions, we asked these attorneys whether reverse half-a-loaf planning is permitted in their states. This strategy involves the client making an uncompensated transfer that will incur a penalty period, and then using the remaining assets to purchase an annuity or make a loan using a promissory note. The income from the annuity or promissory note is used to pay the nursing home during the penalty period. Below is a summary of what we learned about the use of this important planning technique around the nation.

We will report on other findings from the survey in future newsletters. Our thanks to all those who took the time to respond to ElderLawAnswers' DRA implementation survey and to those who set aside even more time for follow-up interviews.

Reverse Half-a-Loaf Being Widely Used

Our respondents reported that reverse half-a-loaf is permitted in most states that have implemented the DRA. Connecticut and Alabama are notable exceptions. In states where the strategy is permitted, reverse half-a-loaf is a popular planning technique among attorneys who answered our survey. Sixty-four percent of responding attorneys use reverse half-a-loaf.

Overall, gifting half of the assets and buying an annuity with the other half is the most popular way to use the technique, but many attorneys buy a promissory note and a few have the gift returned. When the money is returned -- either through a promissory note or annuity -- 59 percent of attorneys stated the money was returned to the original grantor while 16 percent paid the provider directly.

To get a fuller picture of what is happening around the country, we spoke with attorneys in New York, Maryland, Ohio, Georgia, and Colorado.

[Paul Mitchell](#), an elder law attorney in Aurora, Colorado, was able to use promissory notes until spring 2007, when the state revised the regulations to say that a promissory note is an asset. Lutherville, Maryland, attorney [Jason Frank](#) has not been able to use promissory notes because until recently the state also has been counting promissory notes as an asset. But Frank is hopeful that the law is changing. He told us there were recently two cases where the promissory notes were clearly irrevocable and the state accepted them.

While promissory notes are technically allowed in her state, Beachwood, Ohio, attorney [Laurie](#)

[G. Steiner](#) has discovered that state workers have a hard time understanding them. Steiner currently has a case involving promissory notes that is going to a second hearing. Her client applied for Medicaid, and the state imposed a nine-month penalty period. When Steiner went back to the state to tell them that the promissory note had been paid off and to ask that the penalty period be reduced, the state applied an additional four months instead.

Georgia has no problem with promissory notes, but it hasn't been allowing annuities as part of a reverse half-a-loaf strategy, according to attorney [Miles Hurley](#) in Atlanta, Georgia. Hurley says the state has been counting annuities as an asset as opposed to an income stream. He is currently testing the waters to see if he can get an annuity approved. New York attorney [Bernard Krooks](#) also noted that there have been some negative decisions on annuities in his state, but he believes those were based on bad facts.

Promissory Notes vs. Annuities

Both Krooks and fellow New York attorney [Richard Shapiro](#) employ the reverse half-a-loaf strategy, but they differ on whether to use annuities or promissory notes. In general, Krooks does not use annuities because New York is one of the few states that allows spousal refusal. When he is planning for a married couple, he finds spousal refusal to be more effective than spousal annuities.

When planning for an individual client, Krooks uses gift and promissory note. According to Krooks, fair hearing decisions have "come out consistently in favor of promissory notes." Shapiro, on the other hand, prefers to use an annuity because he believes he can get a "closer number" with the annuity than with a promissory note. While Shapiro believes that promissory notes "can be more tricky to get the equal monthly payments right," he hasn't had any rejected. In fact, he has had three favorable fair hearing decisions.

Colorado's Mitchell uses gift and annuity to protect clients' assets. The tricky part for him is making sure the income from the annuity does not exceed the client's income limits.

While Maryland attorney Frank would ultimately prefer to use promissory notes, Frank currently uses both gift and annuity and gift and return as planning techniques. With gift and return he does two applications. First, he gives away the assets. He applies for Medicaid and is denied. A month after the first application, some of the gifted money is returned. He applies again and the penalty period is reduced. Frank prefers gift and return over gift and annuity because the way the cost of care is calculated -- just room and board -- saves money for clients. The problem is that it does require a gift tax, which is why some clients prefer gift and annuity.

Hurley has been using promissory notes to do reverse half-a-loaf planning in Georgia. So far he has not had any problems with the notes. To be safe, he includes rebuttal letters from people who would normally buy notes on the secondary market, stating that they would not purchase the note.

While the gift and annuity method of planning works well in Ohio, Steiner prefers to use the gift and promissory note, even with the difficulty she is having explaining the method to case workers. She prefers promissory notes because an annuity is irrevocable, and if the client dies before the annuity is paid off, the family must wait to get the money back. In addition, the annuity is a set amount of dollars while the promissory can be rewritten as long as there are family members who can be trusted. To protect the money loaned with the promissory note, she has family members set up a limited liability company to hold the money.