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Pleading Poverty

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By Donald Jay Korn

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Few things can play havoc with a thoughtful financial plan as surely as a long stay in a nursing home. According to the *Genworth Financial 2008 Cost of Care Survey*, a private room costs $209 per day on average nationally, which adds up to more than $76,000 a year. In parts of Connecticut and Massachusetts, as well as metro New York and San Francisco, the average annual cost runs into six figures.

Despite what some clients might think, Medicare pays only about 15% of the nation's nursing home bills. Medicaid pays nearly three times as much—but Medicaid is a federal-state welfare program that steps in only after people have depleted most of their assets. Therefore, "Medicaid planning" has become a prime concern for many seniors and their younger relatives. The object is to keep some assets in the family while still qualifying for Medicaid and thus off-loading the responsibility for nursing home fees.

Qualifying Basics

People qualifying for Medicaid are allowed to keep household goods, a car, term life insurance, up to $1,500 in a mortuary trust and burial plot and up to $2,000 in cash. They can also keep a house. There are limits, however, on how much home equity they can have if they want Medicaid to pay for nursing home bills. For married couples, one spouse must meet the above requirements for Medicaid to pay his or her nursing home bills. The other spouse, known as the community spouse, can have up to $104,400 is assets in 2008 and no more than $2,610 per month in income.

The Herculean task of qualifying for Medicaid should not be underestimated. "I recently helped my 86-year-old aunt get approved for Medicaid," remembers Connie Stone, who heads Stepping Stone Financial in Chagrin Falls, Ohio. "I felt privileged to be able to do so, but it was a tremendous amount of work." The time and paperwork involved was overwhelming, according to Stone.

Even after her aunt spent down her assets and was finally approved for Medicaid, the hard work was not yet done. "Ohio has a resource [asset] limit of $1,500 for Medicaid," Stone says. "My aunt gets income from a pension and from Social Security. We have to keep on top of things, to see that her bills are paid promptly. We pay her property tax each month rather than quarterly, for example, so that she doesn't have a buildup of cash in the bank."

Because such planning is quite complex and clients typically must use up most of their assets in order to qualify, Medicaid generally should be a last resort for long-term care. Still, clients without long-term-care insurance must be creative in searching for ways to pay for nursing home stays.

Unfortunately, Medicaid planning has become much more difficult since Congress passed the Deficit Reduction Act (DRA) of 2005, which made significant changes to the Medicaid look-back period and waiting (or penalty) period. The look-back period refers to the time frame during which Medicaid can look at a person's records to see if he or she has given away any assets. The waiting period is the amount of time a person is penalized for giving away assets and must wait until Medicaid coverage can begin.

Closing Loopholes

"When Congress passed the DRA, the Medicaid planning party was pretty much over," says Rick Shapiro, who heads Investment & Financial Counselors in West Hartford, Conn. One provision of this law extended the look-back period to 60 months. Formerly, this period was 36 months, except for transactions involving trusts; now, the 60-month period applies to all applicants.

To see how this might work, suppose Joan Jones is a 75-year-old widow with about $400,000 in assets. She lives in an area where nursing home stays average $10,000 a month, so a few years in a nursing home could wipe out her assets. She gives most of her assets to her daughter Lynn, who promises to help Joan with day- to-day expenses. This gift takes place in October 2008.

If Joan needs to go into a nursing home in November 2013, she can spend down her few remaining assets and apply for Medicaid. "When she applies, she must reveal any transfers within the prior 60 months," says Robert Fleming of Fleming & Curti, a law firm in Tucson, Ariz. Because more than 60 months will have passed since she transferred assets to Lynn, Joan need not reveal the October 2008 gift on her application for Medicaid, which will be approved if Joan has virtually no assets and scant income.

A different scenario occurs, however, if Joan applies for Medicaid in 2010 or 2011. Then she must reveal the 2008 transfer to Lynn, and a waiting period may be enforced. The waiting or penalty period is calculated by dividing the amount transferred by the average cost of nursing home stays in the area.

"Before the DRA passed in 2005, the waiting period would be calculated from the date on which the transfer occurred," Shapiro says. Now the waiting period won't start until the applicant is already in a nursing home and meets all the other requirements for Medicaid eligibility. "Put simply, applicants can't really beat the system the way they previously could," Shapiro says.

The Medicaid waiting (penalty) period shouldn't be confused with the Medicaid look-back period. Assume that Joan's transfers within the 60-month look-back period total $300,000. She'll have a 30-month wait before she can qualify for Medicaid: $300,000 divided by the $10,000 per month average cost of nursing home care in her area. If she has transferred $350,000 within that look-back period, she'll have a 35-month wait.

New Strategies

Suppose that Joan has a 35-month wait. As mentioned, this waiting period won't start until she has been in a nursing home and spent down her assets. Someone—not Medicaid—has to pay her bills during this period. Thus, giving away assets may not provide the required relief if the original owner needs nursing home care in the next five years.

Clients like Joan need some new planning tactics to help them pay for nursing home care. Here are some approaches financial advisors might want to consider to help their clients avoid transferring money in the eyes of the government:

Reverse half-a-loaf method. In the above example, Joan might hold on to her $400,000 until she must go into a nursing home. Then she could give all of those assets to Lynn. Assuming the average cost is still $10,000 a month, Joan will have a 40-month wait until she can qualify for Medicaid.

This strategy, which Fleming calls the "reverse half-a-loaf method," calls for Lynn to pay those $10,000-per-month nursing home bills. "Under the new Medicaid rules, such payments will reduce the waiting period," Fleming says. Each $10,000 payment from Lynn would reduce the waiting period by one month.

In this example, after Lynn has made 20 payments, spending $200,000, the waiting period will have dropped to 20 months. By then, Joan will have satisfied the 20-month requirement, so she can go on Medicaid. Lynn would get to keep $200,000 (half the transfer), rather than use all $400,000 to pay for a long stay in the nursing home.

"States are not in agreement as to how they will respond to this strategy," Fleming cautions. "In some states, it will not work, or not work reliably." The waiting period might not be reduced if the recipient of a transfer pays the nursing home bill

or gives some money back to the original owner. Fleming says this is one reason to work with a local attorney who keeps abreast of state Medicaid rules.

Another possible problem in the above scenario would result if Lynn refuses to pay Joan's nursing home bills. Joan would run out of money while Medicaid wouldn't pay during the waiting period. What would happen to Joan?

"I've seen situations where a nursing home was ready to put someone who couldn't pay out on the street," Stone says. Other nursing homes that don't want the confrontation and adverse publicity of an eviction might find a reason to transfer a non-payer to a hospital and not readmit him or her later.

Immediate fixed annuities. Tim Brown, a planner in Eden Prairie, Minn., has another strategy to protect assets from possible nursing home outlays. He describes two of his clients, a couple with substantial assets, mainly in retirement plans, but one spouse is in poor health. "After several meetings with a local elder law attorney, we were advised that the healthier spouse could put his assets into immediate fixed annuities that would pay out no longer than his life expectancy. Then those annuities would not be considered available to pay for the wife's care, if it's needed." In essence, the money used to buy the annuities would be subtracted from the client's assets without a penalty-igniting transfer.

"Treatment of annuities is very state specific," says an elder-law attorney in another state, who prefers not to be quoted. In his state, he believes that buying an immediate annuity is "dangerous" if help from Medicaid is a goal.

Again, the DRA plays a role. That act requires the annuity to name the state as primary beneficiary (secondary if there is a spouse still living at home). In addition, the annuity must now meet several criteria; it must be actuarially sound, irrevocable, non-assignable and free of balloon payments.

Unless all those criteria are met, the annuity purchase may be considered a transfer, subject to the Medicaid penalty rules. Moreover, some states have taken the position that such an annuity can be valued and thus counted as an asset in the Medicaid calculation.

529 plans. In certain states, funds transferred to a 529 college savings plan might be considered exempt assets for Medicaid purposes, Shapiro says. "In New York, for example, a transfer to a 529 plan may be ignored if the young beneficiaries are spending the money in the account for higher education."

Services rendered. Money spent for services rendered also might not be considered transfers, according to Shapiro. "One of my accounting clients is helping to care for his elderly father-in-law, who is still living at home," he says. "My client's wife, the man's daughter, also helps. They're charging about $20,000 a year, which they consider to be reasonable for the time and effort involved." Paying unreasonable amounts—$400 an hour to go shopping, for example—might be considered transfers, subject to a Medicaid penalty.

"My client and his wife are doing this to see that this elderly man gets good care, to keep an eye on his house and also for financial reasons," Shapiro says. They receive some current income, after tax, and they are reducing the amount that might be spent on a nursing home in the future.

Housing allowance. Another way to obtain some shelter, literally and financially, is to put money into a home. Prior to the DRA, the Medicaid asset count excluded unlimited amounts of home equity; that's still true for Medicaid applicants with a spouse who is occupying the house. Homeowners without a spouse can have up to $500,000 worth of home equity and still qualify for Medicaid, while some states have raised the ceiling to $750,000.

After a Medicaid enrollee's death, states can recover from the estate any money paid for nursing home care; typically, the home will be sold to raise the cash. This transaction might prove to be a good deal for the decedent's heirs.

"In our area, private patients in nursing homes might pay around $280 per day, while Medicaid pays nursing homes $90 a day," says Bill Baldwin, president of Pillar Financial Advisors in Waltham, Mass. Therefore, heirs may be better off repaying the state at Medicaid rates rather than seeing their inheritance depleted by full-fare nursing home bills.

What's more, federal law prohibits this estate recovery if the deceased nursing home resident has a surviving spouse still living in the house, Fleming says. "A few states have tried to recover their Medicaid expenses after the death of the surviving spouse." In fact, he says, the "community spouse" can sell the house a year after the other spouse qualifies for Medicaid without having to repay nursing home costs.

An LTC Option

Instead of spending down all of their assets and relying on Medicaid, clients may choose to cut the risk of expensive nursing home stays by buying a long-term-care (LTC) insurance policy. If an insurance policy will pay $100 or $150 a day when nursing home care is required, the client may preserve assets, and avoid Medicaid.

Beth Ludden, senior vice president for long-term-care insurance product development at Richmond, Va.-based Genworth Financial, points out that some LTC policies are specifically designed to make it easier to qualify for Medicaid, if necessary. "Since the early 1990s, these policies were sold under the Partnership for Long-Term Care program in California, New York, Indiana and Connecticut. Under the DRA of 2005, this program is expanding to other states." More than a dozen new states already are participating and others are likely to follow.

In their original form, most Partnership policies offered dollar- for-dollar shelter of assets in case Medicaid was needed. Suppose, for example, Bob Jackson bought a policy that would pay up to $100,000 of benefits for long-term care in a nursing home or elsewhere. If Bob exhausted those benefits and needed more long-term care, he could apply for Medicaid yet still retain $100,000 of assets.

The DRA changed certain aspects of Partnership policies, largely for the better. "There are some differences between the current Partnership policies and the original ones," Ludden says. "For example, formerly, policies had to offer certain benefits, which varied by state. Now, most LTC policies can qualify."

The new rules also stipulate that policies sold to individuals 60 and younger must have compound- inflation protection. With compound- inflation protection, the benefit increases by a higher dollar amount each year. If the buyer is between 60 and 71, the policy can have either compound- or simple-inflation protection. With simple inflation protection, the benefit increases by the same dollar amount each year. If the buyer is over 75, inflation protection is not required.

In addition, the original Partnership rules required policyholders to exhaust benefits before qualifying for Medicaid, Ludden says. "Now you can apply for Medicaid while you're still getting insurance benefits and need more services. You can protect assets and qualify for Medicaid, which would become a supplement to your LTC policy."

In today's increasingly mobile society, it's important to ask what happens when a client buys a policy while working in one state and subsequently retires to another. "The DRA requires new Partnership states to provide reciprocity unless they specifically opt out, and so far no state has chosen to opt out," Ludden says. "That means a resident of one state who buys a Partnership policy and moves to another state with a Partnership program should be able to enjoy the same Medicaid benefits." She adds that the four original Partnership states are excluded from this reciprocity requirement, but they can choose to participate; Connecticut and Indiana have reciprocity with each other.

Beyond reciprocity, other issues may arise with Partnership LTC policies. Some policyholders may have too much income to qualify for Medicaid, regardless of their assets, and some may prefer to receive long-term care at home or in an assisted- living facility, where Medicaid often won't pay.

"Clients who have so much income probably would not be candidates for Medicaid, regardless of whether they have an LTC policy," Ludden says. It is true, she adds, that Medicaid generally pays for nursing home care rather than for at-home care or assisted living, but that's one reason to buy an LTC insurance policy that gives a choice about where care is received.

"Of the Partnership policy purchasers in the original four states, only 1% have had to access Medicaid," Ludden reports. "Buying a Partnership policy provides clients with LTC choices, along with the peace of mind that if the worst happens,

they may have Medicaid as an alternative," she adds. FP Senior Editor Donald Jay Korn's mystery novel, Payable on Death, is available at Amazon and other online booksellers.