

PLAN TODAY
FOR A SECURE TOMORROW
*The Benefits of Medicaid Planning
With an Income-Only Trust*



THE BENEFITS OF MEDICAID PLANNING WITH AN INCOME-ONLY TRUST

Sarah had never given much thought to nursing homes. All she knew about them was that her father did not want to go to one. He had made his intentions clear on many occasions.

As her dad got older, Sarah and her siblings resolved that if anything ever happened to him, they would work together to take care of him at home. No one looked at long-term care options, and no one worried about paying for nursing home care.

Then, when Sarah's dad was 75, he suffered a series of strokes. At first, the family struggled to take care of him on their own. Before too long, though, it became apparent that he needed more care than they could provide. A nursing home was their only option.

Sarah did her research, and found a nice place nearby. When she found out how much her dad's room would cost, she was rendered speechless: almost \$92,000 a year! She was even more shocked to find out this was about average, nationally speaking.¹

Dad had always saved diligently, and he had hoped to pass a small inheritance on to each of his children. However, after three years in the nursing home, the savings he had worked a lifetime to build had vanished. So had his children's inheritances. At this point, Sarah helped him apply for Medicaid. He qualified, and his Medicaid benefits picked up where his savings had left off. Not only did they lose life savings but the state "recovered" dad's house after his death to reimburse itself for money it had spent on dad's care.

What Sarah and her dad didn't know was that he didn't have to impoverish himself in order to qualify for Medicaid...and neither do you. Additionally, their home could have been preserved for the kids without jeopardizing Medicaid benefits.

The need for nursing home care does not have to catch you off guard. A visit with a qualified estate planning and elder law attorney – one who has experience helping families sort through their long-term care nursing home options and understands how the Medicaid program might apply to your situation – can help you understand the choices available to you and prepare for the future with a clear plan for how to pay for a nursing home without going broke or losing the family home.

One of those choices is a special kind of trust called a Medicaid Income-Only Trust. To understand why it is an effective option, you first have to know a little bit about how Medicaid qualification works – and why the Medicaid program is the best alternative for families paying their nursing home bills.

PAYING FOR NURSING HOME CARE

Your options for paying for nursing home care fall into four main categories:

1. *Long-Term Care Insurance:* Long-term care insurance is gaining popularity as a means of paying for nursing home care. It has a number of advantages. For example, many long-term care policies pay for services like home health care, instead of limiting coverage to nursing homes or other extended care facilities. However, in order to qualify for long-term care insurance, you have to be healthy. And even if you plan far in advance and purchase a policy while you are relatively young, premiums can be expensive. This may be why there are still relatively few people – currently about 8 million Americansⁱⁱ – who have long-term care insurance.
2. *Medicare:* Many people assume that Medicare will pay for nursing home care. The truth is, Medicare provides very limited long-term care coverage; up to 100 days of “skilled nursing” care per “spell of illness.” Because of the way these terms are defined, many Medicare recipients who need nursing home care receive fewer than 100 days of Medicare coverage.
3. *Self-Pay:* This is the way many people fund their nursing home care, at least at first. They pay out-of-pocket until their savings are depleted, then they apply for Medicaid.
4. *Medicaid:* With the costs of nursing home care too high for most people to fund on their own, Medicaid has become the default long-term care insurance plan for the middle class. The Medicaid program provides healthcare coverage for certain groups of people (including those over age 65) who have restricted incomes and resources. The federal government provides partial funding for the program and it sets the overall Medicaid guidelines. Each state interprets and applies the guidelines for its own residents, meaning that the exact criteria you must meet to qualify for Medicaid can vary from one state to the next.

QUALIFYING FOR MEDICAID: AN OVERVIEW

After you have demonstrated that you medically need nursing home care, you must pass a *means test* in order to qualify for Medicaid. Under the means test, your income and certain assets are scrutinized to make sure that they are below the state eligibility limits.

ASSETS

For purposes of the means test, your assets are divided into two categories: *countable* and *exempt*. Exempt assets include:

- Your home, up to certain equity limits

- Personal belongings such as clothing and jewelry, as well as furniture and other household items
- One motor vehicle, as long as it is used as transportation for you or a member of your household for medical visits
- A designated funeral fund for you with a value of up to \$1,500 or a prepaid funeral plan of a reasonable amount, typically up to \$10,000
- A life insurance policy with a face value of \$1,500 or less
- Certain assets that are considered “inaccessible”
- If you are married and your spouse’s total income does not reach the statutory minimum, certain other assets may be deemed exempt in order to raise your spouse’s total income up to the minimum.

These assets are not counted toward your eligibility limits; they are ignored for purposes of the means test.

Your countable assets, on the other hand, are valued and totaled. Countable assets generally include:

- Cash
- Checking and savings accounts
- Stocks and bonds
- Mutual funds
- Cancelable prepaid funeral accounts
- Certain trusts
- Certain real estate
- Certificates of deposit
- Motor vehicles (other than your primary car or truck) and boats
- Most other assets

The total value of countable assets you are allowed to have varies from state to state, and it changes each year based on inflation and other factors.

Currently, to qualify for Medicaid, you are permitted to have no more than \$2,000 in countable assets. If you are married, your spouse who does not live in a nursing home (called a “community spouse” under Medicaid guidelines) can typically keep half of your joint countable assets up to a maximum of \$120,900.00.

THE LOOK-BACK PERIOD

To keep Medicaid applicants from giving away assets in order to qualify for benefits, the federal government has enacted what is known as a *look-back period*. When you apply for Medicaid,

your financial records for the previous five years will be examined, and asset transfers that violate the rules will trigger a penalty. The penalty is a delay in Medicaid benefits for a certain number of months. The number of months is determined by dividing the value of the transfer by your state's average monthly cost of nursing home care.

For example:

Mark gives \$30,000 in stock to his daughter. Two years later, Mark suffers a stroke and needs to enter a nursing home. When he applies for Medicaid, the \$30,000 transfer is divided by \$5,000 (the average monthly cost of nursing home care in his state).

\$30,000 divided by \$5,000 equals 6, so Mark's benefits will be delayed by 6 months; he will have to pay his nursing home bills out-of-pocket for this length of time.

There are certain exceptions to the look-back rule. For example, you can make penalty-free transfers to:

- Your spouse
- Your child who is blind or has special needs (or to a trust for the benefit of that child)
- A trust that is solely for the benefit of a person with special needs under age 65

INCOME

Medicaid also applies income limits to nursing home residents and their spouses. Currently, a nursing home resident is permitted to keep \$30 per month in NC; \$40 per month in KY. If your income exceeds the maximum, the excess is paid to the nursing home as a contribution toward the cost of your care.

If you are married, your spouse is generally allowed to keep his or her full income; it is not factored into the Medicaid calculations, and in most states your spouse is not required to contribute any portion of his or her income toward your nursing home bills.

IT PAYS TO PLAN AHEAD

The goal of Medicaid planning is to work within the Medicaid guidelines to convert enough of your countable assets into exempt assets that, when the time comes for nursing home care, you qualify for Medicaid benefits.

Medicaid pre-planning involves working with an experienced estate planning and elder law attorney while you are still healthy, far in advance of any need for nursing home care.

With enough time, your attorney can help you transform your countable assets into exempt assets in a way that optimally benefits you and your family, and do so outside of the five-year

look-back period. He or she can also help you avoid recovery of your assets by your state Medicaid agency, preserving those assets so that they can be passed on to your children after you and your spouse are gone.

HOW A MEDICAID INCOME-ONLY TRUST WORKS

When you engage in Medicaid pre-planning, there are a number of strategies you can use to protect your assets.

One approach is to transfer your assets to a family member or a close friend and ask that person to safeguard your property and use it for your benefit.

Another approach is to establish a trust that meets Medicaid guidelines and transfer your property into the trust. For example, in order to meet Medicaid guidelines, a trust must be irrevocable (if you have already established a Revocable Living Trust for probate-avoidance purposes, it won't work), and you, as the trust's grantor, can only have access to the trust's income – **not** the principal.

Why use a Medicaid Income-Only Trust instead of making a direct transfer of your property to your child, another relative, or someone else you trust?

Let's look at Anne and her son John to see the benefits.

Anne is 70 years old. She is recently widowed and has one son, John. At the moment, Anne is in perfect health. However, she has a family history of Alzheimer's disease, and she worries that she might need nursing home care in the future. She also worries about how she'll pay for nursing home care. Anne has \$300,000 in savings. Too little to pay for a long nursing home stay, but too much to qualify for Medicaid.

Anne's son, John, is very financially responsible and he is extremely loyal to his mother. Anne wonders if she should just give the \$300,000 to John. As long as she stays healthy for at least five years, she won't have to worry about the Medicaid transfer penalty, and she knows she can count on John to use the money to take care of her.

While it seems like a simple solution, this type of direct gift is generally not the ideal strategy – even under the best of circumstances. Here's why:

CONTROL

When you transfer property directly to another person – even to someone you trust a great deal – you put yourself at risk because you lose control over the property.

While John would never intentionally misuse his mother's money, sometimes circumstances arise which are beyond our control. For instance:

- What if John has guests in his home and one of them slips and falls? If the guest sues John and wins a judgment for more than the limits of his homeowner's insurance policy, that guest turns into John's creditor. He or she can then collect John's property – including the money given to John by Anne – to satisfy the judgment.
- What if John's wife files for divorce? If John has deposited Anne's \$300,000 into his family bank account or otherwise mixed it with his wife's money, then Anne's money could be treated as a marital asset. This means that John's ex-wife could walk away with part of Anne's money as part of the divorce.
- What if John dies? The moment Anne gives her \$300,000 to John, it becomes his money. In the event of his death, the terms of John's will control who inherits the money. The money might go to John's wife, one of his children, or to another family member or friend. The question is, would this new person feel the same sense of loyalty and responsibility to Anne?

Instead of giving John the \$300,000, Anne can put the money into a Medicaid Income-Only Trust naming John as both the trustee and the beneficiary of the trust. Anne can retain the right to receive income from the trust, and she can retain certain limited powers over the trust, such as the power to substitute trustees or the power to substitute beneficiaries.

This solution means that Anne avoided giving away everything and becoming dependent on John. Not only is Anne guaranteed an income stream from the trust, the trust assets are shielded from John's creditors and from other misfortunes he might encounter.

TRANSFER VALUE

Another potential problem with a direct transfer of property arises because of the five-year look-back period. Medicaid pre-planning is done under the assumption that you won't need nursing home care for at least another five years, but we all know that life can be unpredictable.

DIRECT TRANSFER

What if Anne decides to give \$300,000 to John, hoping to beat the five-year look-back period, but three years later she gets sick and needs to go into a nursing home?

As we have seen, Medicaid applies penalties to most transfers that are made within five years of applying for benefits. This five-year window is known as the *look-back period*. The value of the transfers made during the look-back period determines a Medicaid recipient's *penalty period* – the length of time after otherwise qualifying for benefits that the recipient will have to pay for his or her own nursing home care before the recipient will begin to receive Medicaid benefits.

Think of the five-year look-back period like a basket. When you apply for Medicaid, every transfer you've made (with a few exceptions) within the past five years is put into the basket. Then, the state Medicaid agency looks at the value of each transfer in the basket and totals the values. This total is divided by the average monthly cost of nursing home care to determine the penalty period.

If Anne made a direct transfer of \$300,000, then needed nursing home care three years into the look-back period, the calculation would look like this:

- A transfer was made during the look-back period.
- Its value was \$300,000.
- In Anne's state, the average cost of nursing home care is \$6,000 per month.
- \$300,000 divided by \$6,000 is 50, so Anne's penalty period is 50 months.

This means that after she submits her Medicaid application and otherwise qualifies for Medicaid nursing home coverage, Anne will have to pay out-of-pocket for 50 months of nursing home care before her Medicaid benefits kick in.

SOLUTIONS OFFERED BY A MEDICAID TRUST

A Medicaid Income-Only Trust can dramatically shorten the penalty period.

When you transfer assets into this trust, the state Medicaid agency still sees a transfer in the look-back basket for a penalty period. However, because the assets are held by an Irrevocable Trust, the value of the assets is divided into two categories: the *remainder interest* and the *retained life interest*. The number that counts for Medicaid look-back purposes is only the remainder interest. It is calculated according to a government formula based on your age at the time of the transfer.

For example:

Anne's transfer of \$300,000 occurs when she is 70 years old. According to the government's formula, her retained life interest is \$181,566 and the value of the remainder interest – the number we're interested in for Medicaid purposes - is \$118,434.

Again, let's assume that Anne gets sick three years into the look-back period, and she needs to go into a nursing home. When she submits her Medicaid application, here is how her transfer penalty will be calculated:

- A transfer was made during the look-back period.
- Since the transfer was to a Medicaid Income-Only Trust (rather than a direct transfer) we look at the value of the remainder interest, rather than the total value of the assets placed in the trust.

- The remainder interest is valued at \$118,434.
- In Anne's state, the average cost of nursing home care is \$6,000 per month.
- \$118,434 divided by \$6,000 is 19.74. Therefore, Anne's penalty period is 20 months.

When Anne transferred her \$300,000 into the Medicaid Trust rather than giving it directly to her son John, she reduced her Medicaid penalty period from 50 months to 20 months. In other words, she saved herself more than two years' worth of nursing home expenses.

INCOME TAX

Often, parents own income-earning assets, such as bonds or certificates of deposit that they want to transfer to their child as part of a Medicaid pre-planning strategy. One disadvantage of making a direct transfer is that, once the transfer is made, the asset belongs to the child and the child becomes responsible for paying income tax on the asset. When the parent is retired and the child is still working, the child is likely to be in a higher income tax bracket. This is not a good strategy.

Let's use Anne and John as an example once again:

Imagine Anne had \$300,000 invested in a CD earning 5% interest, or \$15,000 in annual income. If Anne transferred the CD directly to John, he would be taxed on the income at his 28% tax rate. On the other hand, if Anne transferred the CD into a Medicaid Income-Only Trust, she would be taxed on the income at her 15% income tax rate.

GIFT TAX

Making a direct transfer creates another potential tax issue. If the value of the assets transferred exceeds \$14,000, the IRS requires the person making the transfer to file a gift tax return. Under federal gift tax law, you are permitted to give away up to \$14,000 per year, per person to an unlimited number of individuals without filing a gift tax return. If you give more than \$14,000 within one year to any individual, you are required to report the amount of the gift by filing a gift tax return. If you exceed your lifetime gift tax exemption (an amount set by Congress that can vary from year to year), you may be required to pay a gift tax.

When you transfer assets into a Medicaid Income-Only Trust, the IRS considers the gift incomplete for gift tax purposes. Therefore, you do not need to file a gift tax return, nor do you need to worry about paying gift taxes on the transfer.

CAPITAL GAINS TAX

When you transfer an asset directly to your loved one rather than using a Medicaid Income-Only Trust, you could be denying your loved one a significant future tax benefit: a "step-up" in basis. Here's how it works:

Basis is the starting value from which the IRS calculates a seller's capital gains tax.

Imagine Anne originally bought her house for \$150,000. Today, it is worth \$300,000. Anne's *basis* in the property is what she invested in it, or \$150,000. If she transfers it directly to John, he gets her basis in the house. If he decides to sell the house next year, after an increase in real estate values, for \$350,000, he will pay capital gains tax on the difference between the selling price and his basis:

\$350,000	Sales Price
<u>-150,000</u>	Basis
\$200,000	Taxable Gain

On the other hand, if Anne transfers the home into a Medicaid Income-Only Trust and designates John as the beneficiary, he will receive a step-up in basis at Anne's death. This means that John's basis in the property would be the value of the property on the date of Anne's death.

Imagine the value of the property at Anne's death is \$350,000. If Anne chose to use a Medicaid Income-Only Trust, then John's basis in the property would be \$350,000 rather than Anne's original basis of \$150,000. If he chooses to sell the property right away, he will not pay capital gains tax on the transaction.

\$350,000	Sales Price
<u>-350,000</u>	Basis
\$0	Taxable Gain

MEDICAID RECOVERY

Under federal law, after a Medicaid recipient dies, the state is required to recover whatever benefits it paid for that person's care from the recipient's estate. It is important to note that the state cannot try to recover any benefits if the recipient leaves behind any of the following:

- a living spouse
- a child who is blind or has special needs
- a child under the age of 21

However, after a Medicaid recipient's spouse dies, and assuming the recipient does not leave behind a child who is blind or has special needs under the age of 21, the state Medicaid agency begins its recovery efforts.

Once again looking at the example of Anne and John, imagine that Anne transferred her \$300,000, including her home, into a Medicaid Income-Only Trust, with John as the beneficiary. She remained healthy for 6 years, making it well beyond the look-back period. Then, she became ill and needed to go into a nursing home. Anne qualified for Medicaid and spent several years in

the nursing home. When she passed away, Medicaid had paid a total of \$400,000 in nursing home bills on Anne's behalf.

Now, it is time for the state Medicaid agency to attempt to recover from Anne's estate. The \$300,000 Anne transferred into the trust has been sitting there, untouched, all these years.

Because the Medicaid Income-Only Trust is an Irrevocable Trust and follows all the appropriate rules, it is not part of Anne's estate for Medicaid purposes. Therefore, it is not an asset the state Medicaid agency can take in repayment of Anne's nursing home bills. The property in the trust goes to John rather than being paid to the state.

FLEXIBILITY

Another advantage of the Medicaid Income-Only Trust as a Medicaid planning tool is its flexibility. An estate planning and elder law attorney experienced in Medicaid planning can tailor your trust to accomplish a wide range of goals, depending on your particular needs. For example:

- For married couples who know which spouse will need nursing home care in the future, the right to income can be tailored so that it is retained by the healthy spouse. This avoids a situation where trust income is paid to the spouse in the nursing home, who must then surrender most of that income to pay for his or her care.
- Your home (up to certain equity limits) is an exempt asset for Medicaid qualification purposes. However, it is often the item of property targeted by state Medicaid agencies for asset recovery efforts after a Medicaid recipient dies. Transferring your home to a Medicaid Income-Only Trust can protect it and preserve it, allowing you to pass it on to your beneficiaries.
- Your estate planning and elder law attorney can help you use a Medicaid Income-Only Trust in combination with other Medicaid planning strategies to help you make the transition to nursing home care as financially pain-free as possible. For example, if the look-back period is a concern, your attorney can help you set aside a portion of your resources to buy a special Medicaid-qualified immediate annuity to help you fund the cost of nursing home care during any penalty period you might encounter.

READY TO GET STARTED?

The focus of this guide has been on planning for nursing home and long-term care as far in advance as possible, and where Medicaid benefits are concerned, this is the best approach to take. However, it is important to remember that it's also never too late to plan.

There is another type of Medicaid planning called *crisis planning*. It focuses on people who are facing an immediate need for nursing home care. Even if you, your spouse, or your parent is

already in a nursing home, it pays to talk to an experienced estate planning and elder law attorney. He or she may be able to help you qualify for Medicaid benefits while preserving at least a portion of your savings for yourself and your family.

No matter where you are in the planning process, remember that Medicaid planning is a complex topic. The rules are complicated, they change frequently, and they vary from state to state. The strategies that work for one family might not work for another. That's why it is important that you find a trusted attorney to guide you – one with proven experience in Medicaid planning. From there, he or she can help you navigate the rules and make sure you have the best possible plan in place.

ⁱ <https://www.genworth.com/corporate/about-genworth/industry-expertise/cost-of-care.html>

ⁱⁱ <http://www.aaltci.org/long-term-care-insurance/learning-center/fast-facts.php>

ABOUT THE ACADEMY

This report reflects the opinion of the American Academy of Estate Planning Attorneys. It is based on our understanding of national trends and procedures, and is intended only as a simple overview of the basic estate planning issues. We recommend you do not base your own estate planning on the contents of this Academy Report alone. Review your estate planning goals with a qualified estate planning attorney.



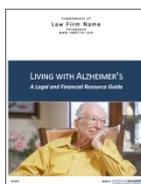
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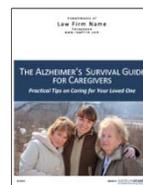
A Family Guide on Medicaid Planning: What it is, How it Works, and Why You Need a Plan



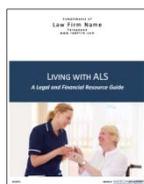
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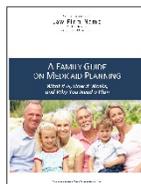
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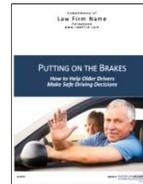
The Alzheimer's Survival Guide for Caregivers: Practical Tips on Caring for Your Loved One



Living With ALS: A Legal and Financial Resource Guide



A Family Guide on Medicaid Planning: What it is, How it Works, and Why You Need a Plan



Putting on the Brakes: How to Help Older Drivers Make Safe Driving Decisions