Gifting and Medicaid

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Abstract:

This paper discusses issues of gifting and planning alternatives as they relate to Medicaid eligibility. Background on gifting from a tax perspective is presented. This is followed by a review of Medicaid eligibility criteria, focusing on transfers of property. Specifically, the paper looks at transferring a residence; gifts to family, others and charities; and transferring assets to trusts. The paper concludes with a brief overview of Special Needs Trusts that can be established to provide support for disabled individuals. Donors can transfer property to these trusts without lessening the disabled individual's access to Medicaid benefits.

Key words: Medicaid, Gifting, Protecting Assets, Transferring Assets, Special Needs Trust

Introduction

In 1965 Medicare and Medicaid were enacted as Title XVIII and Title XDC of the Social Security Act, extending health coverage to almost all Americans age 65 or over and providing health care services to low-income children deprived of parental support, their caretaker relatives, the elderly, the blind, and individuals with disabilities. Medicaid funding was available to States starting January 1, 1966 (Anonymous, 2006). Medicaid law has changed since, with the most recent and significant change occurring in February 2006 when the Deficit Reduction Act of 2005 (DRA-05) was put into law (Zumpano, 2007). That Act significantly tightened rules for qualifying for Medicaid's help with long-term care after making gifts.

Individuals typically become eligible for Medicaid after using up all but about $2,000 of their cash and investments. There are exceptions that vary state to state but an individual can generally keep his or her house and car. One way of reaching this $2,000 threshold without spending money is to give it to someone, often one's children (Greene, 2007). Estate planning, which traditionally was about taxes or avoiding probate, has become more comprehensive because of the changing dynamics of our health care system, which forces individuals to be either rich enough to pay for it all or so poor and not able to pay for anything. It provides nothing for those in between, which includes the 32 million households – out of the 101 million total households in the United States - that have $100,000 to $500,000 of assets (Zumpano, 2007).

This paper will discuss issues of gifting and planning alternatives as they relate to Medicaid eligibility. Background on gifting from a tax perspective will be presented. This will be followed by a review of Medicaid eligibility criteria, focusing on transfers of property. Specifically, the paper will look at transferring a residence; gifts to family, others and charities; and transferring assets to trusts. The paper will conclude with a brief overview of Special Needs Trusts that can be established to provide support for disabled individuals. Donors can transfer property to these trusts without lessening the disabled individual's access to Medicaid benefits.

Gift Defined

Under common law, a gift is a transfer made gratuitously and with donative intent. The definition of a gift for tax purposes differs. Chapter 12 of the Internal Revenue Code sections 2501-2524 provides guidance on gifts. Section 2511(a) provides that the gift tax is to apply "whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible." Reg § 25.2511-1(c)(1) states that "any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax." "Donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer" Reg. § 25.2522-1(g) (1) (Campfield et al., 2006).

A gift is deemed to occur if the donor retains direct or indirect control of the property. This includes the donor having the ability to recall the property, revoke the gift, or replace the trustee with him or herself. The donor has to put the property beyond the donor's "dominion and control." In addition to the question of when and if a gift is complete, many other issues arise including what basis the donee has in the transferred gift, interest free and low interest loan, gifts of services, indirect gifts, co-ownership, and gifts by trustees (Campfield et al., 2006).

Medicaid Eligibility Criteria

The Deficit Reduction Act of 2005 (DRA) changed the commencement date of the period of ineligibility attributable to a gift for gifts made on or after February 8, 2006, placed a cap on the value of an exempt residence, and extended the look-back period for gifts to five years from three.

Pre-DRA law stated that the period of ineligibility that flowed from a gift started on the date of the gift. Under DRA the period of ineligibility does not start until the elder is in the nursing home, applies for Medicaid and can show that he or she is eligible for Medicaid but for the earlier gift. If, for example, that gift generates a five-month period of ineligibility (determined by taking the amount of the gift and dividing it by the average monthly cost of a nursing home) he or she will be ineligible for the next five months during which time he or she has to pay because Medicaid will be denied. Meanwhile the nursing home has no source of reimbursement (Gilfix and Krooks, 2007). Some lawyers have labeled the new law the Nursing Home Bankruptcy Act because of the expected economic impact on nursing homes. Nursing homes may get stuck with the bill for a senior's period of ineligibility because the penalty period starts to run when the patient applies for and is already receiving nursing home care. It will be impossible for nursing homes to learn about an asset transfer when admitting a patient, so they may take the patient in and then find out about the penalty period. Under federal law, a nursing home cannot discharge a patient unless it has found a placement elsewhere (Hsieh, 2006).

Previously a residence of any value was exempt and not counted. Under DRA for applications filed after January 1, 2006, a residence with an equity interest (market value less debt) greater than $500,000 presents a barrier to eligibility. States have the option of increasing this cap to $750.000 (Gilfix and Krooks, 2007). The amount of equity that exceeds $500,000 in the residences of individuals in nursing homes that receive Medicaid is the amount that is now countable. This amount will increase with inflation each year beginning 2011 (Weisman, 2007).

Now regulators can look at any gifts made as long as five years before the application (Greene, 2007). The change in the rule for gifts removed a disadvantage for trusts used to protect assets. Trusts previously had a five year look-back period while gifts had a three-year look-back period (presumably because people who used trusts were wealthier or more sophisticated and were doing so to skirt the Medicaid rules). Complicating matters is that the federal government oversees Medicaid but individual states administer the program and state rules can vary significantly. Gifts or transfers made before the new law was signed in February 2006 were grandfathered. (Lauricella, 2007(1)).

Transferring a Residence

"Individuals often transfer their home to their children to protect it from the nursing home. The truth is, in most cases the home is exempt when determining Medicaid eligibility. If the house is transferred without reserving a life estate, there is a loss in a step-up in basis at the client's death and a completed gift has occurred. If it is transferred with a reserved life estate, a gift of the remainder interest has occurred without the ability to utilize the annual gift tax exemption because it is not a present interest gift" (Zumpano, 2007, p. 5). The transfer can disqualify an individual from Medicaid for 60 months or more. (Zumpano).

When an individual retains a life estate interest, he or she is giving away an interest in the home but the full benefit of the gift does not take effect until the donor dies. The putting off of possession of the property allows an individual to value what he or she is giving away in accordance with IRS charts based upon age when giving the gift. In many states the starting point for the home's valuation is not fair market value but assessed value, which is often lower. If the home is given to children without reservation of a life estate, the children's basis for income tax purposes is the original cost of the home with minor adjustments (Weisman, 2004).

Under Medicaid laws, transferring ownership of a home, usually in the form of a gift is subject to the look-back period. By including what is known as a "special power of appointment" clause in a deed, a homeowner not only retains control over who will ultimately own the home but also shields the home from potential Medicaid liens and starts the look-back clock ticking and eliminates the capital gains problem for the children. For Medicaid purposes, this is considered a completed transfer. For tax purposes, since the parent reserves the right to change his or her mind and retitle the property to someone else, it is considered an incomplete transfer which only becomes complete on the death of the parent. When that occurs, the children benefit from a stepped up tax basis equal to the market value of the property at the time of the parent's death (Romano, 2005). "Peter Brogan, head of the legal department at the Judicial Title Insurance Agency in Manhattan, said that if the special power of appointment clause is properly drafted, the strategy will pass muster not only for Medicaid and federal and state tax purposes but for title insurance purposes as well" (Romano, 2005, p. 11.2).

There are additional ways to gift a residence without risking Medicaid eligibility. A spouse can transfer his or her ownership in a home to the other spouse without penalty (Weisman, 2007). A residence may be transferred without penalty to a sibling with 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 the child served as the caregiver for the parent and kept the parent out of a nursing home for that two-year period). 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 [Reed v. Missouri Department of Social Services, ED 87348 (Mo. Ct. App. Div. June 13, 2006)]. A Louisiana appeals court found the terms of a personal services agreement that called for a significant lump-sum payment made to a child was an arms-length exchange of services for funds [(La. Ct. App., No. 2005 CA 1904 (Sept. 20, 2006)] (Gilfix and Krooks, 2007).

Trusts can also be used. Philip Bouklas, a New York lawyer, is more often using irrevocable income-only trusts in situations where individuals want to pass on a house or other assets to a child. By using an income-only trust instead of just deeding the property over to a child, the parent can still live in the house and even sell it. The trust also offers tax advantages over simply changing the name on the deed (Lauricella, 2007(1)). It is important that the trust be an irrevocable trust. If revocable, all of the assets in the trust are counted in the Medicaid calculations. A house that was an exempt asset may become non exempt because it is in the revocable trust (Lankford, 2004).

Gifts to Family, Others and Charities

Federal law requires states to investigate transfers and gifts made during the five year look-back period. If a transfer for less than fair market value is found, the state must withhold payment for care during a penalty period determined by dividing the transfer value by the average monthly cost for nursing home care. The DRA limits tactics that have been used to preserve assets such as loans to children that automatically cancel on the parent's death (Bartizek, 2007). The five-year look-back rules don't necessarily apply to every gift. Small gifts – to grandchildren, for example – are not normally considered in this calculation. Medicaid typically looks at any transaction larger than $1,000, but there is no "minimum amount" rule preventing it from looking at smaller gifts or transactions. This is especially true when there appears to be a pattern of smaller transactions which total up to large amounts (Matthews, 2008). The regulations in New York do not specify an amount as to gifts. Some counties require the caseworker to question transactions over $1000. Others question transactions over $5000. (Lauricella, 2007(2)).

Common gifts such as gifts to children or grandchildren for tuition, birthdays, or weddings may be deemed impermissible transfers if made within the look-back period. Even gifts made five years ago to charities or religious institutions could be considered impermissible (Weisman, 2007). A simple gift to a child or grandchild for college, or to your church to build a new hall, can lead to disqualification for Medicaid for up to five years or more (Zumpano, 2007).

Gifts made to family members, friends or charities within the previous five years may be considered the giver's assets and are subject to recovery by the state to cover the cost of care, according to the state of Pennsylvania. Under another Pennsylvania statute, children may be held liable for the cost of care during the penalty period, even if they haven't received gifts from their parents. Some gifts will still be protected such as those in an "established pattern of giving" for reasons other than reducing assets to qualify for Medicaid (Bartizek, 2007).

Individuals are advised to be careful using boilerplate attorney documents, in particular as they pertain to gifting clauses. Those documents typically do not cover specific issues including "…clauses about gifting, real estate transactions, or the ability to make asset transfers to affect Medicaid eligibility" (Koco, 2008, p.17). Attorney authorized gifts for estate planning and Medicaid planning purposes 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 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 [In the matter of Ferrara, No. 05156, slip op. (N.Y. Ct. App. June 29, 2006)] (Gilfix and Krooks, 2007).

In Makedonsky v. North Dakota Department of Human Services, 746 N.W. 2d 185 (N.D., 2008), the plaintiff appealed a lower court ruling denying her application for Medicaid benefits on the ground that certain assets transferred to her daughters by her attorney-in-fact were available resources to her for purposes of determining Medicaid eligibility. On further appeal, the lower court ruling was affirmed by a three-to-two vote of North Dakota's highest court. Minnie Makedonsky entered a nursing home in August 2002 and at that time executed a durable power of attorney appointing her daughter as her attorney-in-fact. Between November 2002 and September 2005, the daughter made gifts of $159,000 of her mother's assets to Minnie's four daughters. On September 8, 2005, Minnie executed a "statement of intention to gift" stating that she had freely and voluntarily made those gifts and was not influenced by anyone in making the gifts. In February 2006, Minnie applied for Medicaid benefits and was denied on the ground that she had made disqualifying transfers during the 36 month look-back period. The court held that the gifts were made on September 8, 2005, when Minnie executed the statement of intention to gift. The Supreme Court majority stated that a reasoning mind could reasonably conclude that Minnie's assets were actually available to her until she executed the statement of intention to gift. The dissenting judges concluded that Minnie had made completed gifts without due influence and that the statement of gift was a mere ratification and related back to the date of the transfers. The specter of undue influence surfaced because the attorney-in-fact was also a donee. This case blends property law, agency law, trust law, and Medicaid law. Property law principles focus on the elements of a gift: intent, delivery and acceptance. According to the dissenting judges, the statement of intention, as a ratification would, under the law of agency, relate back to the date of transfer (Volkmer, 2008).

A creative gifting strategy referred to as "half a loaf giving" involves a nursing home resident giving away assets that will cause him or her to be ineligible for Medicaid for a period of time and then purchasing an annuity that is not countable for Medicaid that will cover the cost of the nursing home for that period of time. In this way, annuities are used to effectively provide gifts to family members. Another tactic is a "reverse half a loaf giving" that involves giving away assets during the look-back period and then applying for Medicaid. This would disqualify the individual for a period of time. If part of the gift is returned, the returned money would reduce the disqualification period and that money could be used to pay for the care during the disqualification period. For example, a $100,000 gift when the average monthly nursing home cost is $5,000 would result in 20 month's ineligibility. If $50,000 is returned, the ineligibility period is reduced to 10 months and the $50,000 can then be used to pay for those 10 months of nursing home care (Weisman, 2007).

Transferring Assets to Trusts

"Whatever you can get, Medicaid can get" (Zumpano, 2007, p.4). All assets in a revocable living trust are considered an available resource when determining Medicaid eligibility. Most revocable living trusts convert to a family trust at the grantor's death, permitting income or principal to the spouse or other beneficiaries pursuant to ascertainable standards. Traditional estate planning lawyers often create an irrevocable trust granting the trustee ascertainable standards to distribute income or principal for the benefit of the grantor or spouse. While this may work for typical asset protection, there is an absolute exception in the Federal Medicaid law that treats all assets in discretionary trusts created by the applicant or spouse an available resource when determining Medicaid eligibility (Zumpano, 2007).

Under the current law, the trust must be irrevocable, which means the grantor cannot revoke, terminate or change it. The trust must not allow payments to the grantor of principal but can pay income from the trust (interest and dividends). It is advisable to add a provision that the trust can be changed if the law changes (Weismann, 2004).

Special Needs Trusts

Special needs trusts (SNT) – sometimes called supplemental needs trust – are not counted as an asset when determining eligibility for government programs. The trust can be revocable or irrevocable and is typically set up by parents or grandparents who appoint trustees to use the money to pay for expenses not covered by SSI and Medicaid. They can be funded with life insurance, family gifts and inheritances. A SNT is better than leaving money in an outright inheritance (Aschkenasy, 2008).

More than 41 million Americans, or almost 15% of the population age 5 and older, have some type of disability according to 2007 Census data. Many disabled people will outlive their parents. In 1993, Congress permitted special-needs individuals under age 65 to have trusts funded with their own money – such as from a legal settlement or inheritance – and still have access to government benefits. More common are third-party trusts in which parents provide funding for the trust that benefits children. Funds in the trust are not considered assets of the special-needs individual as long as there is an independent trustee who controls distribution of the money and the disabled person cannot just take cash from the trust at will. Trustees should avoid paying money directly to the person with special needs, since that may disqualify him or her from government benefits. Grandparents and others should structure their estate plans to leave gifts or inheritances to the SNT rather than to the disabled person. Beneficiary designations on retirement accounts and life insurance policies should go to the trust. The SNT will provide funds to pay for certain expenses that enhance a disabled person's quality of life while not cutting off access to government benefits such as Medicaid and SSI (Silverman, 2008).

The trustee of the SNT manages the funds and can make disbursements for things public funds do not cover such as dental care, books, a pet, clothing, a haircut, music lessons, or an afternoon at the movies. The trustee can hire a case manager, therapist or friendly companion. It is recommended that if the prognosis is unclear, the SNT should give the trustee flexibility to cope with whatever facts present themselves, pleasant or not. Never let the beneficiary receive assets directly in his or her name, as ownership will likely disqualify him or her from public assistance. Always use a SNT or a discretionary trust that can direct funds to the SNT, if it becomes necessary. Plan to prevent "accidental gifts" made to the beneficiary. Make sure nothing flows to the beneficiary by default – laws of intestate succession, life insurance, annuities, or retirement plans. Do not set up custodian Uniform Transfers to Minors Act (UTMA) accounts or 529 education plans for the beneficiary (Cane, 2007).

Conclusion

Many individuals may eventually have to go to a nursing home. If an individual is very wealthy, he or she may have little difficulty paying for that care. If an individual is very poor, he or she will be able to get assistance from Medicaid. For the many people in between, planning is necessary to minimize the financial challenge of funding nursing home care. For those people, Medicaid can be an option.

The Deficit Reduction Act (DRA) of 2005 drastically changed the way financial planning could be done. In the past, an individual could have been able to give financial gifts to his children and grandchildren and not worry about those gifts disqualifying him or her for Medicaid. Now there's a five-year "look-back" period, which means that the state Medicaid authorities will inspect financial transfers and gifts going back at least five years, and penalize him or her by delaying Medicaid eligibility if there are any transfers within that period. Because of the Medicaid look-back rules, if one is to do any type of estate planning or Medicaid planning, the earlier you can do it, the better (Weisman, 2008).

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