ESTATE PLANNING

Ideas to Help You Plan for Your Future

Peter J. Brevorka, Esq.

(716) 856-4200
pbrevorka@gmclaw.com

Gibson, McAskill & Crosby, LLP
Buffalo, NY

Volume 2 *Issue 7*

MUST A LIFETIME OF SAVING BE SPENT ON A NURSING HOME?

Not a week goes by that I don't get a call from someone about the possibility of protecting some of the family's assets from being consumed by nursing home expenses. So, I would like to give you some of the information about what is involved in protecting the family's assets.

Basically, you are required to pay your nursing home expenses out of your own assets. Once all of your assets are gone so that you are indigent, Medicaid will then pay your nursing home expenses. Medicaid is a combined state and federal program of medical assistance for the poor. The basic law is federal, but the Medicaid program is administered by each state, so there are also specific applications and interpretations of the law which are peculiar to each state. A comparison of state laws will demonstrate the differences in application and interpretations. I will comment on the application of the Medicaid program in New York and North Carolina.

> *"The basic law is federal, but the Medicaid program is administered by each state, so there are also specific applications and interpretations of the law which are peculiar to each state."*

Medic**aid** is **not** Medic**are**. Medicare is the federal program of health and hospital insurance for those over 65. Medicare has only very limited application to nursing home expenses. Generally speaking, Medicare covers 80% of the first 100 days of nursing home care following hospitalization. After that you pay the expenses until your resources are exhausted; then Medicaid takes over.

THE ETHICS AND LEGALITY OF TRANSFERS

For some people there is an ethical issue about whether they should transfer assets to family members in order to become indigent and thereby qualify for Medicaid. The ethical issue is a client's decision. Various statutes permit some transfers and still allow Medicaid assistance. My position as an attorney is to advise the clients on what the law is, and what they can legally do. They must make their own ethical decisions. If you decide to make the transfers they must be done properly or they could disqualify you from Medicaid assistance.

Let's assume that you have to go into a nursing home and you are not married (I will comment later on married persons). You spend most of your funds on the cost of the nursing home. This can range from $3,000 to over $6,500 per month, depending upon where you live. Once you have spent your assets down to almost nothing you apply for Medicaid through the state Department of Social Services (DSS).

In reviewing your application, the DSS will require that you provide copies of your financial records including bank and brokerage records. DSS reviews the previous three years to see if you made any gifts of your assets. This is a "3-year lookback". The lookback period is five years if you made transfers to any sort of irrevocable trust. If DSS determines that you have not made any transfers during the lookback period, you will qualify for Medicaid. If you have made transfers during the lookback period, then a calculation is made to determine the "penalty period". The penalty period is the number of months during which you are not eligible for Medicaid due to transfers.

The penalty period is computed by taking the total of the transfers made during the lookback period, and dividing by the average cost of a nursing home in your area as determined by DSS.

In Western New York, that average cost is approximately $5,300 per month; in North Carolina that number is $3,000 per month. The result of that calculation is the

CONTINUED ON PAGE 2

number of months during which you would be ineligible for Medicaid assistance to pay your nursing home expenses.

Assume you are living in Western New York before entering a nursing home and you give away $53,000. One year later your funds are almost gone and you apply for Medicaid. DSS in evaluating your Medicaid application would go back three years to see if you made any gifts. The gift of $53,000 made a year ago would be found, and that $53,000 would be divided by $5,300 (the average cost of a nursing home in Western New York). The result of that calculation would be 10. That 10 is the number of months **from the date of the gift** that you would have been ineligible to qualify for Medicaid – the so-called penalty period.

In the example you made the application for Medicaid one year after the gift, the penalty period of 10 months would have expired, and you would qualify for Medicaid.

In North Carolina the result would be different. The average cost of a nursing home for purposes of the calculation is only $3,000 per month, in North Carolina. Dividing $53,000 by $3,000, would result in a penalty period of 17.66 months, which would be rounded down to 17 months. If you applied for Medicaid 12 months after the gift, DSS would say that you would be ineligible for Medicaid for 7 months unless you recovered $21,000 of the gift and spent it on yourself – if you are in the nursing home, those expenditures would probably be for things for yourself or the monthly nursing home expense.

If a penalty period is imposed, there are provisions in the law for abating the penalty period for hardship, such as if the recipient of the gifts had spent all the money, but in our planning we try to avoid having to rely upon those abatement provisions.

SPOUSAL IMPOVERISHMENT

Married persons are viewed as a single unit in regard to an application for Medicaid by one spouse. One of the reasons for this is that each spouse is legally responsible for the support of the other. Several years ago if one spouse went into a nursing home, the spouse who was left at home would have to spend virtually all of the couple's assets on the nursing home before Medicaid would be allowed.

The Medicaid law was amended to permit the spouse living at home to keep some limited amount of assets and income, to avoid total impoverishment. We refer to the spouse who is still living at home as the "Community Spouse" because she or he is still living in the community. The spouse in the nursing home is called the "institutionalized" spouse.

"The Medicaid law was amended to permit the spouse living at home to keep some limited amount of assets and income, to avoid total impoverishment."

COMMUNITY SPOUSE RESOURCE ALLOWANCE

The Community Spouse is entitled to keep the house and furniture, and a car, regardless of the value of those, as well as an amount of other assets called the Community Spouse Resource Allowance (CSRA). In New York, the CSRA which the Community Spouse can keep is the greater of $74,829 or one-half of the couple's "other assets" as of the date when the institutionalized spouse went into the nursing home, up a maximum of $87,000.

On the other hand, in North Carolina the CSRA is $17,400 or one half of the couple's "other assets" up to a maximum of $87,000. This shows how the laws can vary from state to state.

When the one spouse goes into the nursing home, the Community Spouse should immediately go to DSS and have an "assessment" made. DSS will total up the couple's assets, and then will compute the amount of the CSRA. The goal here is to maximize the total of the assets, so that one-half of that total will reach the maximum CSRA, because the community spouse will be able to keep that maximum CSRA.

The assets beyond the house and contents, one car, and the CSRA, must be spent down by the couple. However, it is important to note that these assets do not have to be spent down on only the nursing home. If the Community Spouse wanted to take a trip to Las Vegas and spend the money on the slot machines, that would be OK. The money merely cannot be given away.

Obviously, we do not encourage the trip to Vegas, but we do encourage a spend down in a way which will benefit the family. For instance, if the house needs any repairs or additions, we recommend that those be made. Since the statute says that the Community Spouse may own a car, regardless of value, we encourage the Community Spouse purchase a new car. The husband and wife can pre-purchase their funerals. For the spouse in the nursing home, purchases might be made for a wheelchair, a TV set, hearing aids, etc. Remember, money not spent on the couple will merely go to the nursing home.

CONTINUED ON PAGE 3

Gifts to family members can also be made. But care must be taken to make sure that when the funds have been spent down to the CSRA amount and application is made for Medicaid, a penalty period won't be imposed.

While the CSRA is computed by DSS when one spouse goes into nursing home, I recommend that you consult with me before that time, so that planning may be done to preserve more that just the CSRA. Families who wait until one spouse is about to enter a nursing home risk losing a great deal. Early planning pays dividends.

COMMUNITY SPOUSE INCOME ALLOWANCE

In addition to the CSRA, the Community Spouse is permitted to receive a monthly income allowance of $2,175. This can come from things like pensions and Social Security, as well as from income generated by the assets held as the CSRA. If the income of the Community Spouse exceeds this Income Allowance, then the excess income must be spent upon the nursing home in order to remain eligible for Medicaid. If the income of the spouse does not meet $2,175, income of the Institutionalized Spouse may be given to the Community Spouse, or additional assets beyond the CSRA may be retained by the Community Spouse to generate additional income.

If the income needs of the Community Spouse are greater than $2,175 per month, such as the cost of housing expenses, DSS may permit an additional amount of income to be retained by the Community Spouse. Sometimes we have to go to court to get this additional income for the Community Spouse.

What I have given you about the Community Spouse Resource Allowance and the income allowance is merely a brief overview. Depending upon the state of your residence, certain other assets may be considered "non-countable" in determining the CSRA. That is, they are not considered in computing the CSRA nor are they considered a transfer if they are given away. Sometimes, assets which are "countable" in determining the CSRA can be converted into "non-countable", thereby disappearing for purposes of Medicaid analysis.

As they say on TV, "Kids this is not something you should do at home." Medicaid planning in order to preserve your family's assets is extremely complicated, and only lawyers who have a thorough background in this sort of thing should be consulted.

ESTATE PLANNING

In addition to planning to preserve assets from nursing home expenditure, it is also necessary to consider estate tax and income tax in doing this sort of planning. Assets gifted to children will carry the parents' original cost basis for income tax purposes. Thus, if the parents bought their home for $25,000 but it is now worth $125,000, if they give the house to the children to preserve it from being sold for nursing home expenses the children will receive an asset which has $100,000 of built-in capital gain upon which capital gains taxes will have to be paid when it is sold.

Careful planning might avoid that tax. For instance, the parents might give the house to the children and retain a life estate in the property. That could result in the house being included in the estate of the surviving parent when he or she passes away, thereby giving the children a "stepped-up" basis equal to the market value of the property at the date of death. The retained life estate disappears at the parent's death, so that there is nothing for the Medicaid lien to attach.

Also, estate planning must be done for the Community Spouse in case he or she predeceases the Institutionalized Spouse. Care must be taken to minimize the amount that would be inherited by the Institutionalized Spouse, because all of that would have to be spent on the nursing home.

LONG TERM CARE INSURANCE

Long Term Care Insurance can provide money if you require long term care, such as in a nursing home. Such a policy will usually pay a certain number of dollars per day while you receive care. Generally, the policy has a maximum number of days for which such payments will be made. The policy premium often remains the same for the life of the policy like a life insurance policy. Unlike life insurance, most Long Term Care policies do not accumulate any cash value; if you stop

CONTINUED ON PAGE 4

> *"In considering a long term care policy one of the important things to look for is whether coverage extends to in-home care."*

Peter J. Brevorka is a partner in the firm of Gibson, McAskill & Crosby, LLP, Buffalo, NY, and counsel to the firm of Turner, Enochs & Lloyd, P.A., Greensboro, NC. He is a member of the New York State Bar Association, North Carolina Bar Association, The Florida Bar, The American Bar Association and is a *Fellow in the American College of Trust and Estate Counsel.*

paying the premium the policy lapses and you are left with nothing.

In considering a long term care policy one of the important things to look for is whether coverage extends to in-home care. Most of us would prefer to remain at home with nursing care.

The premium cost of the policy is usually driven by multiple factors such as your age when you purchase the policy, the condition of your health, the dollars per day that the policy will pay you, the number of days for which the policy will pay, whether there is waiting period before benefits begin, and whether the policy benefits will increase with inflation.

With skilled care in nursing homes now costing hundreds of dollars per day, many people find that a policy which will pay the full nursing home cost will be prohibitively expensive, as will be policies which will pay for long term care regardless of how long you remain in a nursing home. My advice to clients is that they hedge by purchasing a policy which will cover some of their nursing home costs for a period of at most three years. If they go into a nursing home the policy will provide the money to pay some of the nursing home cost while we implement strategies to transfer assets to family members in order to qualify for Medicaid.

INTEREST RATES ARE LOW - THAT MEANS IT'S A GREAT TIME FOR GRATs

A Grantor Retained Annuity Trust (GRAT) is a trust which is designed to freeze the value of assets in a person's estate. The Trust has the effect of transferring appreciation of assets in the trust to family members at little or no gift tax cost.

The way it works is you execute a Grantor Retained Annuity Trust Agreement and fund the trust with assets. In the Trust Agreement you retain the right to receive an annuity from the trust for a period of years. The size of the annuity is often selected to equal what you put into the trust plus what the return would be on the value of the assets used to fund the trust under the current IRS interest rate. If the return is actually greater than that IRS assumed interest rate, the excess return remains in the trust and goes to the family when the trust ends.

> *"The best time to use a GRAT is when interest rates are low............"*

The best time to use a GRAT is when interest rates are low, since there is a possibility that over the term of the agreement the investments in trust will out-perform the current interest rates

For instance, assume you put $1,000,000 into a 5-year GRAT in November, 2001, when the IRS assumed rate of return is 5%, and the GRAT provides that you are to be paid an annuity from the trust of $230,973 per year for the 5 years of the trust. Under the IRS actuarial tables, the present value of the annuity you will receive would equal the $1,000,000 which was put into the trust, and there would be no gift for gift or estate tax purposes.

However, if the assets put into the trust could appreciate at an average rate of 10% per year, at the end of the 5 years the assets remaining in the trust would be worth $200,394. That would be distributed to the family members at no tax cost.

But what if the investments don't out-perform the current interest rates? If the combined income and appreciation of the trust were 5% or less there would be nothing left in the trust at the end of 5 years. However, there has been no cost other than the cost of setting up the trust. Since there was no taxable gift when the trust was created, there would be no use of the gift and estate tax exemption.

If the Grantor dies during the term of the GRAT, what remains in the trust would be fully taxed in his or her estate. For this reason, it is preferable to keep the term of the GRAT relatively short.

Computing the actuarial value of the annuity to equal the initial contribution to the trust is called "zeroing out" a GRAT. The IRS had taken the position in its Regulations that a GRAT could not be zeroed out, and that there was always some taxable gift because of the possibility of the Grantor dying during the term of the GRAT and having the whole trust taxed in his estate. The Tax Court recently handed down an opinion which said that the IRS is all wet on that. The IRS has not acquiesced in that decision. While the IRS could try to challenge a zeroed out GRAT, they would probably not be successful.

The information contained in this newsletter is for general information only. It is not intended as legal advice, nor should it be considered to provide specific advice or recommendation. You should obtain the advice of legal counsel.