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Divorce and Medicaid Planning Strategies

Transferring Assets and Minimizing Spend-Down for Well Spouse While Qualifying the Medicaid Spouse for Assistance

WEDNESDAY, AUGUST 12, 2015

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Graying Divorce and Medicaid Considerations

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The Following Topics Will Be Discussed:

1. Baby Boomer,
2. Divorce Rate, and
3. Graying Divorce Statistics (1-3)
4. Hypothetical #1 (First Marriage)
5. Hypothetical #2 (Second Marriage)
6. Hypothetical #3 (Nursing Home Admission)
7. Hypothetical Cases: Thoughts
8. Medicaid Program Overview
9. Countable vs. Non-Countable Assets
10. Transfer Rules and Penalties

11. Permissible Transfers
12. Saving the House
13. Benefits/Disadvantages of Life Estates
14. Life Estate as a Gift
15. Example of Life Estate Gift
16. Rental Property
17. Irrevocable Income Only Trusts
18. DRA Compliant Medicaid Annuity Options
19. DRA Compliant Medicaid Annuity – Single Person

11. Personal Care Contracts
12. Shifting Income to the Healthy Spouse
13. Long-Term Care Insurance Opportunities
14. Return to Hypotheticals

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Baby Boomer Statistics

- Baby Boomers make up 35% of the adult population.
- 76 Million people were born between 1946 and 1964.
- Between 2011 and 2021, 80 Million people will retire.
- 10,000 people a day are now retiring.
- Beginning in 2015, 48% of our workforce supervisors will begin to retire.

Thought: There are millions of retiring primary wage earners who will be getting divorced.

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Divorce Rate Statistics

- 50 % of first marriages end in divorce.
- 67% of second marriages end in divorce.
- 74% of third marriages end in divorce.

Thought: A large percentage of Graying Divorces involve second and third marriages where each person has children from a prior marriage.

www.divorce360.com

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Graying Divorce Statistics

- In 2010, 1 out of 20 people who were divorced were 65 or older. It is expected that this percentage will dramatically increase.
- Married couples ages 50 to 64 have a divorce rate 4 times higher than couples who are over 65.
- For those aged 65 plus in a remarriage, the divorce rate is more than 3 times higher than the first marriage divorce rate.

www.seniorplanet.org
"Gray Divorce: Splitting Up at 65-Plus"

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Hypothetical #1 (First Marriage)

<u>**Debbie**</u>	<u>**Matt**</u>	<u>**Debbie's Goal**</u>		<u>**Matt's Goal**</u>
43 Years Old	48 Years Old House	House	$125,000	$125,000
2 Children of Marriage	20 Year Marriage	Cash	$ 75,000	$ 75,000
$50,000 Cash	$250,000 Home (joint)	Ret.	$ 25,000	
<u>$25,000 Retirement</u>	$100,000 Cash (joint)	<u>QDRO</u>	<u>$ 50,000</u>	<u>$ 75,000</u>
	<u>$125,000 Retirement</u>			
$75,000 Total	**$475,000 Total**		**$275,000**	**$275,000**

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Hypothetical #2
(Second Marriage)

Debbie	Matt	Debbie's Goal		Matt's Goal
66 Years Old	71 Years Old	House	$125,000	$250,000
No Common Children	10 Year Marriage	Cash	$ 75,000	$100,000
2 Adult Children	1 Disabled Adult Child	Ret.	$ 75,000	$125,000
$50,000 Cash	$250,000 Home (PM)			
$25,000 Retirement (PM)	$100,000 Cash (PM)	**Total:**	**$275,000**	**$475,000**
	$125,000 Retirement (PM)			

$75,000 Debbie **$475,000 Matt**

Total: $550,000

Note: This hypothetical assumes that there is no prenuptial agreement.

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Hypothetical #3
(Second Marriage with Imminent Nursing Home Admission)

Debbie	**Matt**	**Debbie's Medicaid Plan**		**Matt's Goal**
66 Years Old	71 Years Old	House	$ 0	$250,000
No Common Children	10 Year Marriage	Cash	$ 2,000	$173,000*
2 Adult Children	1 Disabled Adult Child	Ret.	Cashed in	$117,240
$50,000 Cash	$250,000 Home (PM)	Spend Down		$ 30,760
$25,000 Retirement (PM)	$100,000 Cash (PM)	* Annuity (Cash to be annuitized) $150,000		
	$125,000 Retirement (PM)			
$75,000 Debbie	**$475,000 Matt**			

What if: Debbie has Alzheimer's and is entering a nursing home. What are Debbie's goals? What are her adult children's goals? What are Matt's goals? What are the goals of Matt's disabled adult child's guardian? What is the standard Medicaid plan?

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Hypothetical #3: Second Marriage with Imminent Nursing Home Admission Special Considerations:

1. Who are the clients?
2. To whom do we owe a duty of care?
3. Do Debbie and Matt need separate counsel?
4. Has the marriage irretrievably broken down? Is this a Medicaid divorce?
5. Do the children need counsel? What about the disabled child?
6. If a spouse is incompetent, how do we get a divorce?
7. Do we need a guardian ad litem?
8. Will the court require that the state be named as a party in interest?
9. What if a disabled adult's child guardian intervenes in the divorce?
10. What are the Medicaid planning options?
11. Are post-nuptial agreements a planning option?
12. Is a bifurcated divorce a planning option?
13. What is fair and equitable?
14. How do judges feel about Medicaid planning in the context of divorce?

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Medicaid Program Overview

- Medicaid is a federal program which is administered by each state. The federal government allows each state to implement regulations within the overall framework of the federal laws. The regulations vary from state to state.
- Medicaid covers nursing home costs and other long-term care assistance for the elderly if they meet certain financial and medical requirements.
- Medicaid and Medicare ARE NOT the same. Unlike Medicare, you must demonstrate a financial need for assistance to qualify for Medicaid.
- Medicaid does not recognize pre-nuptial agreements or post-nuptial agreements.
- In the future, it is uncertain if a state's Medicaid regulatory agency will accept divorce agreements which substantially leave all assets to the community spouse.

Query: Does the regulatory authority have standing to object to Medicaid planning divorces?

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Countable vs. Non-Countable Assets

The healthy community spouse may keep some specific assets which are "non-countable". If assets are "countable", they must be "spent down" before Medicaid eligibility will occur.

NON COUNTABLE

- Primary residence
  (Equity up to $552,000 in NH, $814,000 in MA)
- One automobile
- Savings ($2,000 MA, $2,500 NH)
- Life Insurance – cash value up to $1,500
- Prepaid funeral contracts
- Term life insurance
- Jewelry
- Furniture

COUNTABLE

- Second home
- Additional autos
- All other savings, IRAs, stocks, bonds, CDs, and retirement
- All assets that are not "Non-Countable" including your spouse's assets.

Note: All assets, however titled, are considered as joint assets even if subject to a pre-nuptial agreement.

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Transfer Rules and Penalties

- Medicaid considers any transfer of an asset (or transfer of interest in an asset) by the nursing home resident or his/her spouse during the 5-year look-back period to be a disqualifying transfer unless specifically exempted. All gifts within five years will be a problem.

- Medicaid considers, as a disqualifying transfer, any action taken to avoid receiving an asset. This includes waiving the right to receive a resource (such as an inheritance), or failure to take legal action to obtain a resource (such as a share in the probate estate of a deceased person). **Query:** If a spouse signs a divorce agreement which leaves the majority of the marital assets to the community spouse, is there a disqualifying transfer?

- A disqualifying transfer also includes any action taken which results in making a formerly available asset no longer available for purposes of paying nursing home expenses. **Query:** What if the community spouse disinherits their spouse who subsequently goes into a nursing home and then dies? Is the surviving spouse's (who is in a nursing home) failure to elect against the will a disqualifying transfer?

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Permissible Transfers

The following transfers are permissible:

1. Transfers between spouses.
2. Transferring the home to a child who is blind or permanently and totally disabled, or who has resided in the home as a caretaker for at least 2 years.
3. Transferring resources to a permanently and totally disabled or blind child or to a trust created for the sole benefit of the child.
4. Transferring resources to a special-needs trust created for the sole benefit of a permanently and totally disabled person who was under 65 years of age at the time the trust was created and funded.
5. Transferring the home to the nursing-facility resident's sibling who has a legal interest in the nursing-facility resident's home and was living in the nursing-facility resident's home for at least one year immediately before the date of the nursing-facility resident's admission to the nursing facility.
6. Transferring resources to a pooled trust created for the sole benefit of the permanently and totally disabled nursing-facility resident. [This may be changing.]
7. Transferring resources for the purpose of purchasing a burial account or other prepaid burial plan for the benefit of the institutionalized person or their spouse.

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Saving the House

The primary residence can be transferred out of the name of the institutionalized spouse to any of the following individuals without creating a Medicaid penalty:

- Spouse of institutionalized person.
- A blind, totally disabled, or permanently disabled child.
- Child who resided in the house and acted as a caretaker child for 2 years.
- Sibling of institutionalized person who has a legal interest in the home and who has resided in the home for at least one year prior to nursing home admission.

The home may also be preserved if the institutionalized person has purchased a long-term care insurance policy in Massachusetts with defined limits of $125 per day for at least 24 months. New Hampshire does not have this exemption.

Renting the home to create a stream of income to the institutionalized person can also preserve the home and its value from needing to be sold to qualify for Medicaid. However, the property may be subject to estate recovery.

Conveying the house and reserving a life estate in a Massachusetts primary residence may provide a planning opportunity. This planning tool does not work in New Hampshire.

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Benefits/Disadvantages of Life Estates

Benefits of Life Estates:

- Protects the grantor.
- Receives a step-up in basis at death.
- No estate recovery in Massachusetts. Estate recovery in New Hampshire.
- Recently the laws have changed regarding reverse mortgages. The life tenant can now obtain a reverse mortgage with the signature of the remainder interest holders.

Disadvantages of Life Estates:

- If the property is sold, a portion of the proceeds must be paid to the life tenant.
- You cannot sell the house without the remainderman's signature.
- The money paid to the life tenant will be eligible for capital gains tax exclusion but will be a countable resource.
- The money paid to the life tenant may be subject to a Medicaid lien or Medicaid disqualification.
- You lose control and cannot change the remainderman without their permission.
- The transfer of a remainder interest may be a Medicaid disqualifying transfer.

Query: Are life estates a potential planning opportunity for older divorcing spouses?

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Life Estate as a Gift

How to compute the value of a gift of a partial interest in a property for gift tax purposes:

A transfer of a partial interest in property, such as a remainder interest in the case of a deed with a reserved life estate, must be valued using actuarial tables provided by the IRS. These tables have built-in mortality assumptions and interest rate assumptions. The assumed rate of interest changes monthly with the relevant rates being the "applicable interest rate equal to 120% of the federal mid-term rate under IRC section 1274(c)(1) for the month in which the valuation occurs." IRC Sec. 7520(a)(3); this is the so-called "7520 rate."

Query: In second marriages, can you gift the house to the children of one spouse or the children of both spouses? If yes, how should the property be transferred, ie. outright, reserving a life estate, or in trust? Is there a different result for Massachusetts property vs. New Hampshire property? What if the property is a vacation home? What will happen if one party enters a nursing home within five years?

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Example of Life Estate Gift

In this case, if the property was transferred by the taxpayer (age 66) with a single life estate reserved, the value of the gift is $272,545.00.

Transfer Date: May 2014
Sec. 7520 Rate: 2.4%
Calculation Type: Life Estate
Tax Assessed Value: $400,000
Age: 66

	Life Estate	**Remainder**
Factor:	0.31864	0.68136
Value:	$127,456.00	$272,545.00

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Rental Property

Property that is rented (including the primary residence) is considered “business or non-business property essential to self support” and is, therefore, deemed non-countable by Medicaid. However, it may be subject to a Medicaid lien. See CMR 520.008(D).

EXAMPLE: Mark and Wendy own their home. Wendy owns a premarital family cottage in her own name on the beach in Maine worth $600,000 which she wishes to keep. Mark and Wendy had a prenuptial agreement in which Wendy’s cottage would remain in her name and would not be considered a marital asset. Mark is presently in a nursing home. Wendy rents the cottage to her son, Steve, who will pay them rent of $3,000 per month. This is the fair market rental value. Mark will qualify for Medicaid. Medicaid will place a lien on the cottage, but the lien will be released upon Mark’s passing, as the cottage is no longer part of his Massachusetts probate estate.

Query: Will Medicaid honor the prenuptial agreement? Is there an issue concerning Mark’s elective share of Wendy’s estate if she dies before Mark?

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Irrevocable Income Only Trusts

- It is possible to transfer assets out of your name for Medicaid purposes and still receive some benefit by transferring assets into an irrevocable income only trust. The trust must limit your right to only the income. The principal cannot be accessed during your lifetime. At your death the principal is paid to the secondary beneficiaries of the trust. The funds in the trust are protected and you can use the income for your living expenses. However, if you do move into a nursing home, the trust income will have to go to the nursing home.
- This arrangement is irrevocable. It cannot be changed. You cannot gain access to the trust funds even if you need them for some other purpose. The trust provides an estate planning opportunity.
- You may also choose to place the property in a trust from which even payments of income to you or your spouse cannot be made. Instead, the trust may be set up for the benefit of your children or others.
- Any portion of the principal or income (such as interest) of an irrevocable trust that could be paid under any circumstances to or for the benefit of the institutionalized individual is a countable asset.
- The transfer of assets into an income only irrevocable trust is subject to a 60-month look-back period. The grantor must retain enough funds outside of the trust to cover any needs he may have over the five years, or be willing to take the risk that there could be a gap if he does need nursing home care and his funds run out before the five years pass.
- If properly drafted, the assets will receive a stepped-up basis.
- There are important tax ramifications which must be analyzed.
- Trusts are carefully scrutinized and challenged by the state's Medicaid's legal departments.

Query: Is an irrevocable trust a planning option in lieu of a Graying Divorce or a Post-Nuptial Agreement?

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DRA Compliant Medicaid Annuity Options

- A Deficit Reduction Act (DRA) compliant annuity is a Medicaid planning tool which allows a couple to retain assets in the form of an income stream for the community spouse.
- The DRA compliant annuity must be immediate and irrevocable.
- The funding of the annuity is a valid spend down of excess assets which allows for Medicaid qualification.
- This is not a deferred annuity.
- The state may have to be named as the alternate beneficiary.
- The annuity may not be assignable.

Matt & Debbie have a $200,000 Estate

$117,240 Debbie

$80,760 Nursing Home
$ 2,000 Matt

Debbie purchases an annuity for $80,760 that pays her an income of approximately $ 1,700/Month for 4 years. Matt immediately qualifies for Medicaid.

Query: What if all of the money ($200,000) was Matt’s premarital assets and Debbie and Matt were only married for a few years? How do Matt’s children feel about this result?

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DRA Compliant Medicaid Annuity – For a Single Person

Debbie (age 78) has an Estate of $300,000

- Debbie purchases a 10 year annuity that pays approx. $35,000/ yr.
- Debbie's total income cannot exceed the Medicaid rate.
- The income is paid to the nursing home and then Debbie qualifies for Medicaid.
- The State must be named as the secondary beneficiary of the annuity and is entitled to reimbursement (a lien) for all funds it pays on Debbie's behalf following her death.
- The Medicaid rate is approximately 60% of the private pay rate. It is always better to qualify for Medicaid benefits, even though the Medicaid lien must be repaid, than to privately pay the nursing home. If there are funds remaining in the MQA after Medicaid is paid, the balance of the annuity is paid to the secondary beneficiary of the annuity.

Query: If Debbie is the widow of Matt in a second marriage, can both Debbie and Matt's children be listed as contract beneficiaries of the annuity after the State? How do Debbie and Matt's children feel about this result?

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Personal Care Contracts (PCCs)

- A PCC is a formal written agreement between two or more parties in which one or more of those parties agree to provide personal and/or managerial services in exchange for compensation paid by the party receiving the services.
- The person in need of services must receive fair market value for the resources transferred to the caregiver.
- The PCC must provide a provision requiring the return of prepaid monies if the caregiver becomes unable to fulfill his/her duties under the contract, or if the person in need of services dies before his/her calculated life expectancy.
- Services cannot be rendered on an “as needed” basis.
- Lump-sum payments for future personal services are improper transfers.
- The key is regular, contemporaneous payments for fair market value as well as a well drafted contract which was signed before services were rendered.
- A PCC signed after-the-fact for services previously rendered will incur a transfer penalty.
- There are income tax and worker’s compensation issues which must be considered by the caretaker.
- PCCs are strictly scrutinized by Medicaid’s legal department.

Query: In a divorce, can funds be set aside to fund a PCC? Can we use a “pooled trust” to fund the care? How will the judge interpret a fair and equitable settlement if a large amount of money is segregated to fund a PCC? How will Medicaid treat the funding of a PCC as part of a divorce? How do the respective children feel about these results?

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Shifting Income to the Healthy Spouse

Under the existing rules, the community spouse is deemed to need a minimum of $1,966.25 of income each month. If the community spouse's total income is less than this amount, any income payable to the institutionalized spouse is first allocated to the community spouse to bring the community spouse to the applicable income level. You can also shift income up to a maximum monthly amount of $2,980.50 under certain circumstances. In Massachusetts, this can only be accomplished with a "fair hearing."

Example: Matt is age 85 and Debbie is age 79. Matt has $1,800 in combined Social Security income and a pension while Debbie has Social Security income of only $600 and no pension. Matt is about to be admitted to a nursing home. If Debbie has other allowable expenses which exceed $1,750, we can increase Debbie's combined income to a maximum of $2,931.

MMMNA	$1,966.25	Maximum MMNA	$2,980.50
Debbie's Income:	$ 600.00	Debbie's Income:	$ 600.00
Shortfall:	$1,366.25	Shortfall:	$2,380.50

Solution: File an appeal and request that at least $1,366.25 of Matt's income be transferred to Debbie.

Query: If Matt and Debbie divorce, what happens to Matt's Social Security and pension benefits which Debbie is relying upon to pay her expenses? If Matt pays alimony to Debbie and Debbie enters a nursing home, can Matt file a complaint for modification to eliminate his alimony payment? How do Matt and Debbie's children feel about the result?

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Long-Term Care Insurance Options

If you are healthy and can afford the cost, you should consider purchasing long-term care insurance (LTCI). In addition to providing coverage that can help delay or eliminate the need for nursing home admission, qualifying policies may also exempt the primary residence in Massachusetts from estate recovery. Such policies must meet the following requirements:

- cover custodial as well as skilled nursing care in a nursing facility licensed by the Department of Public Health;
- provide at least $125 per day benefit;
- cover at least two years of nursing home benefits; and
- impose an elimination period of no longer than one year or a deductible of no more than $54,750.

New Hampshire has implemented a complicated LTCI Partnership.

The premium paid is a deductible medical expense. The amount of the deduction depends upon your age and your adjusted gross income.

Query: What if only one spouse can medically qualify for long-term care insurance? Is the purchase of LTCI a possible planning option in a Graying Divorce involving an unequal property division?

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Revisit Hypothetical #3

Debbie, age 66, and Matt, age 71, were married for 10 years prior to their separation 2 years ago. This was a second marriage for both Debbie and Matt. Debbie has two children. Matt has one disabled adult child. Since that time, Debbie and Matt have remained separated, but have not divorced. None of their assets are jointly owned. Matt owns his home worth $250,000, has cash totaling $100,000 and retirement totaling $125,000. Debbie rents an apartment and only has a total of $50,000 in cash and $25,000 in retirement.

Debbie's Medicaid Plan?			**Matt's Medicaid Plan?**	
Debbie		**Matt**	**Matt**	**Debbie**
House	$ 0	$250,000	0	$250,000[2]
Cash	$ 2,000	$173,000 (annuity)	$2,000	$117,240
Ret.	Cashed in	$117,240	$150,000[1]	
Spend Down	$30,760		Spend Down $30,760	

Footnote 1: Special Needs Trust

Footnote 2: In trust with Life Estate to Debbie and remainder to Special Needs Trust.

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Hypothetical #4

Linda

65 Years Old
2 Children
15-Year Marriage
$800,000 Home
$200,000 Cash
$750,000 Retirement

$1,750,000 Total

Rob

70 Years Old
4 Children
A Prenuptial Agreement was Signed
$300,000 Condo
$50,000 Cash
$150,000 Retirement

$500,000 Total

Note: This is a 15-year marriage. A prenuptial agreement was signed before the marriage and is valid. What if the prenuptial agreement was challenged and vacated? Does the state have standing to challenge? Is this a case for an irrevocable trust or a bifurcated divorce?

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Hypothetical #5

Rob and Diane have been married for 35 years. Rob is 65 and Diane is 68. Rob and Diane have recently separated. Rob moved out and began living with his girlfriend and has been financially supporting her for over a year. Rob purchased numerous expensive items for his girlfriend, including jewelry and a car. Diane's health has rapidly deteriorated and she now faces entering a nursing home and requiring Medicaid in the very near future. All of Rob and Diane's assets are jointly owned, including their home with a value of approximately $275,000, retirement accounts totaling $300,000 and cash accounts totaling $50,000. Rob and Diane's oldest daughter resides in their home and has cared for Diane for the year since Rob moved out of the house.

Issues: Since Diane is likely to enter a nursing home prior to finalization of the divorce, how will Medicaid view the gifts made to Rob's girlfriend from joint accounts? How would private payments made to a nursing home affect the allocation of assets in a divorce? What can Rob and Diane do to protect assets from nursing home costs and simultaneously create a fair division of assets during the divorce?

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