Planning for Long-Term Care

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The percentage of Americans over 65 has more than tripled since 1900, and all indications are that the most rapid increase is yet to come in the years 2010 to 2030 when baby boomers start turning 65. This aging of America has contributed to the increase in need for long-term care. Typically, the most expensive type of care is nursing care, with an annual average cost of over $60,000.

Overview of Medicaid

Those who need care often are surprised to learn that Medicare does not pay the expenses of assisted living care and provides only limited benefits for nursing care. The governmental program that provides assistance for nursing care is Medicaid, which covers only applicants who meet strict income and resource guidelines. All of an individual's assets must be considered, including real property, life insurance, and retirement plans. In addition, a married Medicaid applicant/recipient must consider assets held jointly with his or her spouse as well as assets owned solely by the spouse.

For the year 2017, a Medicaid applicant/recipient is entitled to retain only $2,000 of assets in his or her name. The spouse of a Medicaid applicant/recipient is given additional protection which allows a spouse to keep one half of the couple's countable assets. However, for 2017, this allowance cannot exceed $120,900.

Many individuals or couples believe that they do not have sufficient assets to pay for expensive nursing care yet have too many assets to qualify for Medicaid. It is in this daunting context that many seek legal or financial advice to access Medicaid funding.

Conversion of Assets

Baseline planning efforts often involve the conversion of assets from countable to non-countable for purposes of the limitations discussed above. Certain assets are considered non-countable because they are considered essential to the well-being and dignity of individuals, such as the personal residence of a spouse of a Medicaid applicant/recipient. The asset conversion process often includes setting aside money for burial arrangements, making home repairs, purchasing a car, or investing in a non-countable annuity for the spouse of the Medicaid applicant/recipient. These steps trigger no penalty whatsoever. However, North Carolina has implemented an estate recovery program in which the State may make a claim against a Medicaid recipient's estate for the amount of Medicaid benefits paid during the recipient's lifetime. Therefore, without additional planning such as the gifting techniques discussed below, assets that are non-countable during an applicant/recipient's lifetime may be subject to estate recovery after the death of the applicant/recipient.

Gifts

Many take aggressive steps to qualify for Medicaid and/or to avoid estate recovery by making outright gifts of assets to children. When an individual makes an application for Medicaid, the Department of Social Services will analyze all financial transactions made by the Medicaid applicant/recipient and his or her spouse during a "look-back" period, which is the 60 months prior to the application. Gifts made by the applicant/recipient or his or her spouse during the look-back period will result in a penalty period during which the applicant/recipient will be ineligible to receive Medicaid benefits.

With outright gifts of real property, the donor sometimes retains a legal life estate. Under current Medicaid rules, a life estate is not considered a countable asset for nursing care. The retention of a life estate reduces the value of the gift by the actuarial value of the retained life estate based on the donor's age. Therefore, the penalty period, which is based on the value of the gift, is shortened. In addition, under current tax law, the retention of a life estate allows the property to pass to the donee(s) at the donor's death with a stepped-up basis. Thus, if the property is sold after the donor's death, future capital gains tax may be reduced.

A common technique employed with outright gifts is the "half-loaf" or optimal gift method. This method determines the largest amount that can be gifted while leaving the applicant/recipient with sufficient funds to pay for his or her care during the penalty period. As illustrated below, this reduces the value of the gift and, therefore, reduces the penalty period. Assume an individual has $100,000 of countable assets, monthly income of $2,000, and monthly expenses (including the cost of nursing care) of $6,000. If the applicant/recipient made a gift of the entire $100,000, there would be a penalty period of approximately 16 months and the cost of care during the penalty period would have to be paid from the gifted assets or other sources. However, if the applicant/recipient made a gift of $61,165, there would be a penalty period of only 9.71 months and the applicant/recipient could purchase an irrevocable immediate annuity for $38,835 to meet his or her monthly shortfall during the 9.71-month penalty period.

Instead of making outright gifts, an individual may wish to consider making gifts to a trust. A trust may be more desirable for those (i) who do not have good relationships with their children or (ii) who have children who have a high risk of divorce, creditor issues, or bankruptcy. While the terms of the trust typically provide that all income earned by the trust will be distributed to the individual who creates the trust ("Grantor"), the trust must prohibit distributions of principal to the Grantor. The trust may allow distributions of principal to one or more of the Grantor's children who, in turn, could use the distributions for the Grantor's benefit. However, they would have no legal obligation to do so.

Gift Taxes

Gift taxes also play an important role when deciding whether to make gifts to qualify for Medicaid. Currently, an individual may make annual exclusion gifts in the amount of $14,000 to multiple donees without incurring federal gift tax. In addition to these annual exclusions, an individual may make gifts by utilizing his or her federal gift tax exclusion. The federal gift tax exclusion amount in 2072 is $5,000,000 (adjusted for inflation to $5,490,000).

Conclusion

There is no cookie cutter plan that will meet the needs of all individuals who wish to engage in long-term care planning. Rather, plans must be customized to particular family situations depending upon factors such as whether nursing care is imminent, the value of assets, and the makeup of family members. Attention also should be given to avoiding, to the extent possible, adverse gift tax consequences and lengthy penalty periods. Accordingly, it is important to seek the advice of a professional familiar with these rules before making an application for Medicaid or before transferring any assets.

For further information regarding the issues described above, please contact a member of the Trusts &

Estates practice.

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