

**MEDICAID UPDATE**  
**A CLOSER LOOK AT SECELECTED SECTIONS OF**  
**THE DEFICIT REDUCTION ACT OF 2005 AS ADOPTED**  
**BY MASSACHUSETTS REGULATIONS AND RELATED**  
**PLANNING OPPORTUNITITES**

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# Why Understanding the Penalty Period Remains Important with Regard to Advanced Planning Under the Deficit Reduction Act of 2005

## Example:

If an individual transferred assets for less than fair market value to a child in the amount of \$200,000, the related disqualification period would be approximately 26.0 months ( $\$200,000 \div \$7,680$ ). This calculation remains unchanged under both the deficit reduction act of 2005 and the newly enacted Massachusetts regulations adopting such act. The only difference is that the deficit reduction act prevents this ineligibility period from beginning to run on the date of the transfer.

**(C) Value of Asset Gifted**

\$200,000

Average Monthly Cost Nursing Home MA

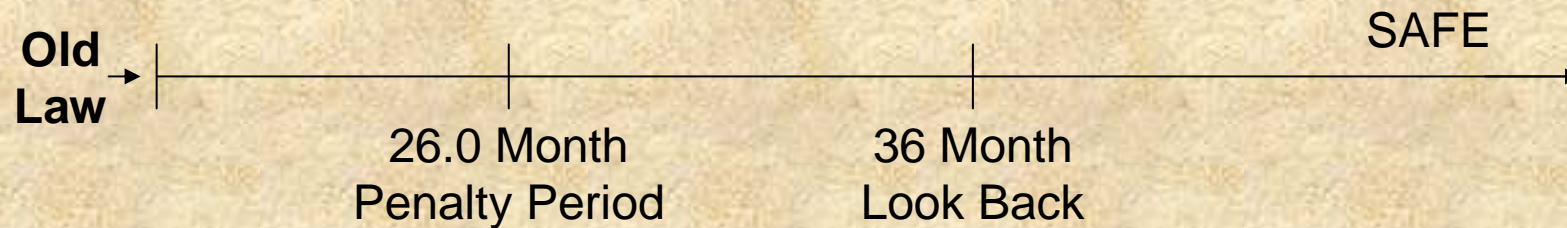
7,680

Period of Ineligibility

= 26.0 Months

**Planning Notes:**

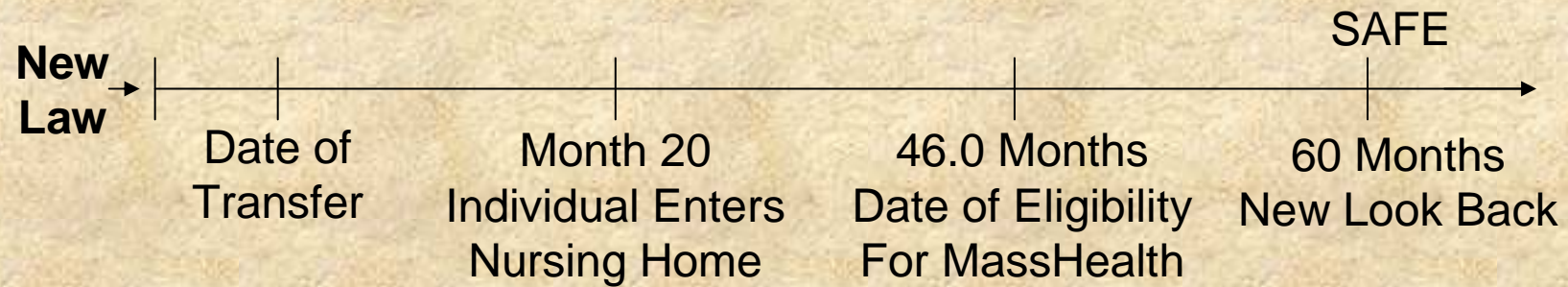
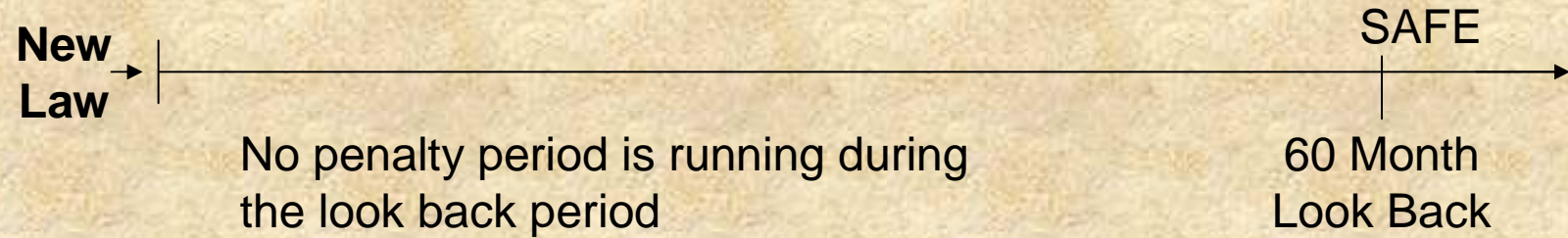
**Transfer To Individual**



**Transfer To Irrevocable Trust**



## All Transfers



# IMPORTANT FEDERAL LAW CHANGE UNDER THE TAX RELIEF AND HEALTH CARE ACT OF 2006 AND REMAINING PLANNING OPPORTUNITIES

## Planning Note:

President Bush signed into law the Tax Relief and Health Care Act of 2006 and as part of this act there was a clarification to the annuity portion of the DRA of 2005. The change was to remove from section 6012(b) of the DRA of 2005 the word “*annuitant*” and replace it with the words “*institutionalized individual*”. It appears that this change is designed to allow MassHealth, upon the death of the community spouse, to recover Medicaid benefits paid on behalf of the institutionalized spouse even if the community spouse never received any Medicaid benefits. MassHealth Operations Memo 07-14 dated September 1, 2007 indicated that it will be issuing a revision to Mass Health regulation 130 CMR 502.007(J)(2)(a)(i) changing the word “*annuitant*” to “*institutionalized individual*”.

### Query:

Can a healthy spouse purchase an annuity with excess assets after the institutionalized spouse has entered a nursing home, without being concerned about passing away prior to the expiration of the annuity, whether it is before or after the institutionalized spouses death, and having the balance of the annuity used to pay for any Medicaid benefits received by the institutionalized spouse?

### Answer:

We believe that the answer must be based on the assumption that Massachusetts adopts the new federal language changing the word *Annuitant* to *Institutionalized individual*, as mentioned above. In this regard then when the community spouse dies during the term of the annuity it appears that the state would be able to recover from that annuity any MassHealth benefits paid on behalf of the institutionalized spouse.

### Annuity planning benefits remain:

All annuities purchased on behalf of the community spouse should be as short a duration as possible. This approach would increase the chances of the community spouse outliving the annuity, thus eliminating the issue as to who the remainder beneficiary is as there would be no annuity left.

## **Annuity for married couples:**

A married couple both age 75, own a home worth \$300,000 and have investments of \$300,000. Husband has social security income and a pension of \$1,500 per month and the wife has social security income of \$750 per month. Husband has just entered a nursing home with no advanced planning in place.=

**Planning Opportunities:**

**- Transfer the home to the community spouse:**

This transfer still qualifies as a permissible transfer and will not create a disqualification period pursuant to 130 CMR 520.019(D)(1). In addition, transfer assets in excess of community spousal resource allowance which also qualifies as a permissible transfer.

**- Purchase Annuity in the Name if the Community Spouse:**

**A)** Amount of Annuity is the total assets less the community spouse resource allowance [CSRA] and the amount the institutionalized spouse is allowed to keep.

- Total Assets	300,000
- Community Spousal Resource Allowance	< 101,640 >
- Amount institutionalized spouse can Keep	< <u>2,000</u> >
- Amount of Annuity	<u>196,360</u>

**B) Result of Annuity Purchase**

- Amount of Annuity	196,360
- Term of Annuity Not to Exceed	/ 2 Years
Life expectancy of 75 year old	
- Number of Months in a Year	/ <u>12</u> Months
- Amount of Monthly Payment to the Community Spouse	\$8,181.66



## **Planning Pointer:**

Since it appears that the Deficit Reduction Act of 2005 requires the state to be named as a remainder beneficiary of an annuity, even though purchased by the community spouse, [Act Section 612a], it is important to make the term of the annuity as short as possible. Such an annuity would not result in a disqualifying transfer as it does not violate the annuity rules as provided in 130 CMR 520.007(J)(1). By making the annuity term as short as possible helps to reduce the risk of there being any remainder left to go to the state as the remainder beneficiary.

## **Half a loaf coupled with an annuity**

### Example:

Jane is 80 years old, has \$302,000 in assets and no real estate and has just entered a nursing home. She has monthly income of \$750 consisting of social security and a small pension. The nursing home costs \$9,000 per month. She would very much like to save some of her assets for her family.

## Solution:

Jane should make an immediate gift of \$150,000 to her children and the balance, less the \$2,000 she can keep, should be used to buy an immediate annuity in accordance with regulation 130 CMR 520.007(J)(1) and (J)(2)(a). This gift would create a disqualification period of 19.5 months ( $150,000 / \$7,680$  per month). (See 130 CMR 520.019(G)(1)) The annuity should be purchased with the remaining \$150,000 and the term must equal the 19.5 months disqualification period created from the transfer. This annuity would be paying to Jane approximately \$7,692 per month for the next 19.5 months. In order to get this disqualification period running, Jane would need to apply for MassHealth benefits and get denied for the sole reason of the recent disqualifying transfer. Massachusetts regulation 130 CMR 520.019(G)(3) indicates that the begin date for a period of ineligibility will be the first day of the month in which the transfer occurred or the date on which the individual would have been otherwise eligible for MassHealth benefits. In this example, Jane would have made a disqualifying transfer, a resident of a nursing home, had less than \$2,000 following the transfer and would have been “otherwise eligible” for benefits thus triggering the start of the 19.5 months disqualification period. Note that Jane’s income, although being used to pay the nursing home during the disqualification period, will be approximately \$558 ( $\$9,000$  nursing home cost -  $\$750$  income -  $\$7692$  annuity) per month short of the full private pay amount. Arguably, if Jane could full pay the nursing home she would not be “otherwise eligible” for benefits and the disqualification period would not begin to run. Once the 19.5 months has expired, the annuity would be exhausted and the transferred money should be protected and Jane would then be eligible for MassHealth benefits.

## How Annuities Can still be an effective planning tools under the Deficit Reduction Act of 2005

**Example:** A single female age 75 has \$302,000 and has just entered a nursing home. The nursing home costs \$9,000 per month and she gets \$1,000 per month social security and a pension of \$612 per month. This means that her money would be used up in 40.6 months:

(a) Monthly Cost for Nursing Home	\$9,000
Less Social Security	\$1,000
Less Pension	<u>\$ 612</u>
Amount short each month	\$7,388
Total Cash Available	/ <u>\$300,000</u>
Numbers of month's money will last	40.6 months

**Purchased an Annuity in Accordance with**  
**[130 CMR 520.007(J)(1)]**

(A) Amount of Annuity: is \$300,000 as the individual is permitted to keep \$2,000 = [302,000 - 2,000]

(B) Term of Annuity: A term certain not to exceed the individuals life expectancy pursuant to 130 CMR 520.007 (J)(1)(b)

(C) Irrevocable: the annuity must be irrevocable.

(D) Remainder Beneficiary: must be the state in the First position unless there is a community spouse or a blind or disabled child which would cause the state to be a remainder beneficiary in the second position. [Section 6012(b)(f)(i)(ii)]

## **Result of Annuity Purchase**

- Amount of Annuity	300,000
- Life Expectancy of 75yr old Female using HCFA tables	/ 12 Years
- Number of Months in a year	<u>/ 12 Months</u>
- Amount of Monthly Payment	\$ 2,083.33

At Risk to Nursing Home

## **Amount of Medical Lien**

- Monthly Cost MassHealth Pays Nursing Home	\$ 6,000
- Less Social Security	\$ <1,000>
- Less Pension	\$ < 612>
- Less Annuity Payment	<u>\$ &lt;2,083&gt;</u>
- Amount short each month that represents the Amount of the MassHealth Lien Building each Month	\$ 2,305

## **Planning Benefit:**

If the individual stays in the nursing home for 40.6 months the outstanding lien that the state would be entitled to would be \$93,583 [ $2,305/\text{month} \times 40.6 \text{ months}$ ]. In addition the annuity paid out \$84,570 [ $2083 \times 40.6 \text{ months}$ ]. The total amount spent out of the annuity was \$ 178,153 [ $93,583 + 84,570$ ]. The total amount still left for the family would be \$121,847 which is far better than nothing which is the amount that would have been left had the family not purchased the annuity. In other words, this approach would allow the parents money to last 68.3 months [ $300,000 / (2,305 + 2,083)$ ] instead of 40.6 months.

# A Closer Look at Life Estate, Long Term Care Planning & Reverse Mortgage

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## Example:

- Consider the case of an individual whose home has an assessed value of \$303,500. At age 75, the life interest portion using Table 90 CM is .60449 of \$303,500 (or \$183,462.71).
- The remainder interest is \$120,038. The penalty is only 16.3 months. ( $\$120,038 \div 7,380$ ) rather than 41.2 months ( $\$303,500 \div 7,380$ )
- This life estate also avoids estate recovery and will provide the heirs with a “step-up in basis” upon death so that a post sale death will not give rise to any capital gain tax to the heirs, provided the sale price is equal to the fair market value on the date of death and the property is sold shortly after the date of death.
- As the individual ages, the value of the life estate decreases. For example, at age 87, the life estate portion is worth .25638 of the fair market value. Assuming the assessed value of the property has increased to \$850,000, the life estate would only be worth \$217,923, much less than the maximum allowed of \$750,000.

## Using a Life Estate Will Not Disqualify an Individual from Obtaining a Reverse Mortgage

- FHA allows the property to be held in a life estate in lieu of a fee simple, under certain conditions. In fact, the guidelines issued the largest provider of reverse mortgages State:

“A life estate is an interest in real property allowing the owner of the life estate to use and enjoy the property during his or her lifetime. On the death of the owner of the life estate, his or her rights in the property cease, leaving fee simple title to the property and the holders of the interest of the property. HUD permits mortgages to be insured if the borrower’s interest in the property is a life estate. However, to encumber fee simple interest in the property, the borrower and all holders of any future interest in the property, must execute the mortgage at closing. Holders of future interests do not execute the note or loan agreement.”

- The guidelines state that a reverse mortgage would not be permitted if the remainder interest is held by an income only irrevocable trust, but this problem can be solved simply by having the trustees of the trust make a distribution of the remainder interest to individual beneficiaries.

- A distribution of the property from the trust will represent a completed gift of the remainder interest valued at the time of the transfer (since the income only irrevocable trust usually is considered an “incomplete gift” for gift tax purposes). Unless the value of the remainder exceeded \$1,000,000, there will be no gift tax consequences.
- The property can be sold during life. If the property is sold during life, a portion of the proceeds must be paid to the holder of the life interest for the value of his or her property interest. The amount is to be determined based upon the relative values of the life interest versus the remainder interest using Table 90 CM.

## **Example:**

At age 86, Borrower is admitted to a nursing home. The reverse mortgage note provides that the loan is due if the Borrower ceases to use the property as their principal residence. (Some notes are ambiguous. Others provide failure to physically occupy the home for 12 consecutive months because of physical or mental illness. Instead of bringing Borrower home for a night, assume the property is sold for \$850,000 when the Borrower is age 87 and the balance on the note is \$200,000.

## VII. Computation Allocation of Sale Proceeds if Property is Held in a Life Estate.

Sale Price	\$850,000
Broker's Commission (5%)	<u>\$ 42,500</u>
Net Sales Price	\$807,500 (after sales commission and expenses)
Life Estate Rate	<u>.25638</u> (from 90 CM Table)
Borrower Proceeds	\$207,026 (life tenant)
Children's Proceeds	\$600,474 taxable at 15% long-term capital gain rate

## VIII. Determination of amount “at risk” for nursing home with Reverse Mortgage

Borrowers proceeds	\$207,026
Loan Repayment	<u>\$200,000</u> (Borrower’s portion)
Amount at risk	\$ 7,026

**IX. Determination of amount “at risk” for nursing home if no life estate was used at the time of the closing.**

Borrowers proceeds	\$807,500
Loan Repayment	<u>\$200,000</u>
Amount at risk	\$607,500

## **X. Tax Considerations:**

If property is sold during life that is subject to a life estate, the portion payable to the life tenant is eligible for the \$250,000 income tax capital gain exclusion while the remaining portion would not be eligible so that the remainderman would need to pay capital gain taxes on their share.