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Medicaid and Asset Preservation: Gifts and Transfers

Transfers of assets in order to qualify for Medicaid long-term care benefits are a useful and entirely legal method of asset protection planning. Because the transferor is over-resourced and hence not eligible, the transferor is willing to give away assets (usually either as an outright gift or in trust) to accelerate Medicaid eligibility.

Assets may be transferred in several ways. These include:

- Gifts
- Transfers to a trust
- Transfers to permitted transferees (such as to a spouse or a disabled child)
- Non-disqualifying transfers

Warning on Asset Transfers

With the passage of the federal Taxpayer Relief Act of 1997, transfers that resulted in the imposition of a penalty or disqualification period for Medicaid eligibility subjected the transferor's ***lawyer*** to ***criminal penalties***, even though the transfers themselves are entirely legal. This law was held unconstitutional in September 1998 by a federal court in New York. Nonetheless, we still include this warning until the law is changed or repealed by Congress.

The law does not apply to transfers that do not result in penalties, such as transfers by one spouse to another. Likewise, the law does not apply when the transfer is made exclusively for a purpose other than qualifying for Medicaid benefits. For instance, persons in good health regularly give away money with the aim to reduce the size of their estates for federal estate tax purposes, not with the intent to accelerate eligibility for Medicaid. Such transfers, even though made for less than fair value in return, should not subject the transferor or the lawyer to criminal penalties.

You should also be warned that under Tennessee law any transfers of assets made by an attorney-in-fact pursuant to a durable power of attorney that does not authorize the attorney-in-fact to give away the principal's property will be closely scrutinized by the Bureau of TennCare, which in certain cases may refer the matter to the District Attorney for investigation.

Gifts

If transfers—that is, gifts—of assets are made, those transfers will likely cause a disqualification (penalty) for Medicaid, unless an exception to the rules applies. A person who transfers assets to qualify for Medicaid must plan for or use other strategies, such as a Special Needs Trust, or Annuity to pay for care during the ineligibility period resulting from the transfer.

The New Gifting Rules

The Deficit Reduction Act of 2005 makes four major changes to the general rules on asset transfers made on or after February 8, 2006:

1) The look-back period for assets transferred at less than fair market value is five years.

2) The penalty for assets transfers will begin on the date on which the individual is eligible for Medicaid and would otherwise be receiving nursing home care based on an approved application for such care but for the application of the penalty period, whichever is later, and which does not occur during any other period of ineligibility. The penalty divisor is set annually by the Bureau of TennCare.

3) States are prohibited from rounding down or otherwise disregarding any fractional period of ineligibility.

4) At their option, States may also aggregate multiple transfers over a period of more than one month and treat them as a single transfer, beginning the period of ineligibility on the earliest date which would apply (for example, on the date of the first transfer instead of the last).

A nursing home resident who makes a gift and retains more than $2,000 would not "otherwise be qualified" because he or she retains too much money to qualify for Medicaid but for the transfer.

The Three Basic Gifting Rules

For gifts and transfers made on or after February 8, 2006, when an application for Medicaid benefits is made, the following three gifting rules are applicable:

1. The number of months of ineligibility for Medicaid nursing home benefits is equal to the number of months of nursing home care given away.
2. The period of ineligibility for Medicaid—that is, the penalty period—begins on the date on which the individual is eligible for Medicaid and would otherwise be receiving nursing home care but for the application of the penalty period, and which does not occur during any other period of ineligibility imposed due to a transfer of assets.
3. Gifts or transfers to trusts made more than 60 months prior to the date of the application for Medicaid do not affect eligibility, no matter how large or how small the gift. This is called the 60-month look-back rule.

Example: On February 1, 2021, Mrs. Jones enters the nursing home with $200,000 in countable assets. On February 10, 2021, she gifts $100,000 to her daughter Jane. She spends the $100,000 she retains on her nursing home care and applies for Medicaid on June 1, 2021, at which time her countable assets are below the Medicaid resource limit. Her application is denied and a period of 455.87 days of Medicaid ineligibility is imposed ($100,000 divided by $219.36), from the date of application, not from the date the gift was made.

This example assumes that, but for the $100,000 gift, at the time of her June 1, 2021, Medicaid application Mrs. Jones meets all of the other criteria for Medicaid eligibility: technical, medical, and financial. Mrs. Jones retained $100,000. Had she applied for Medicaid at the time she made the gift—in order to get the Medicaid penalty period running—a penalty period would not be imposed because her countable resources are above the $2000 Medicaid resource limit.

How Do the Medicaid Transfer-of-Asset Rules Work?

The general rule is that for every month of nursing home care cost given away, the transferor is ineligible for Medicaid for one month. The state Medicaid agency “imposes” a penalty if an application for Medicaid is filed while the applicant is within a Medicaid ineligibility period. Imposition of a penalty does not mean the applicant has committed a crime; it just means that State has found that the applicant is not eligible for Medicaid nursing home benefits. Once the transferor has waited out the ineligibility period, he can apply for Medicaid. For reasons discussed more thoroughly below, a person who has transferred assets should not *apply* for Medicaid until he or she is eligible. Meanwhile, if the transferor is in the nursing home, he must pay the nursing home out of private funds.

Here are some examples of how the Medicaid ineligibility rules work.

Example: Mrs. Jones has $30,000 in a savings account. This is a countable asset. She transfers these funds to her daughter Jane on January 10, and applies for Medicaid. As a result, Mrs. Jones is ineligible for Medicaid for a period of time equal to the amount transferred divided by the average monthly private rate for nursing home care in the state. Assume that the current rate is $6580 Mrs. Jones would be ineligible for Medicaid nursing home benefits for six months ($30,000 divided by $6580 equals 4.55 months, you can also use the daily rate divisor.

In short, because Mrs. Jones gave away $30,000 that would have paid for five months in the nursing home, she is not eligible for Medicaid for fivemonths.

The Baseline Date. The “baseline date” for imposing the Medicaid penalty begins on the date that the individual subsequently applies for Medicaid. The “look-back date” is the date 60 months prior to the baseline date. The “look-back period” is the period of time between the look-back date and the baseline date.

Only gifts or transfers that were made during the look-back period can disqualify the person in the nursing home from receiving Medicaid. For other transfers, or transfers to or from a trust, however, the look-back period is 60 months.

Example: On December 1, 2006, Mrs. Jones gives assets to her daughter Jane. Forty months later, on April 1, 2010, Mrs. Jones enters the nursing home and applies for Medicaid. The look-back date is 60 months prior to the baseline date, which is the date of application.

Example: Mrs. Jones transfers assets to an irrevocable trust and applies for Medicaid 65 months later. The look-back date is 60 months prior to the baseline date, which is the date of application.

In the last example the transfer occurred prior to the look-back date. As a result, Mrs. Jones will not be ineligible for Medicaid due to the asset transfers, regardless of the amount transferred.

In the first example, the transfer occurred during the look-back date. On the date Mrs. Jones made the gift, she did not meet all of the criteria for eligibility for Medicaid: technical, medical, and financial. (She is not in a nursing home.) The period of ineligibility is imposed and begins on the date of application when Mrs. Jones would otherwise be eligible for Medicaid.

The penalty period for transfers of assets is potentially unlimited. This is Rule No. 1 above. The failure to understand this rule can have devastating consequences.

Example: On December 1, 2006, Mrs. Jones gives $400,000 to her daughter Jane and applies for Medicaid 30 months later. Because she applied for Medicaid within the 60-month look-back period, the State Medicaid agency imposes a Medicaid penalty as a result of the gift. The penalty period is 60.79 months ($400,000 divided by $6580/month penalty divisor). Mrs. Jones is ineligible for Medicaid for another 61 months.

Had Mrs. Jones waited until the 61st month after making the gift to apply for Medicaid, the transfer would have occurred prior to the look-back date and would not have disqualified her from Medicaid.

The lesson is clear: an application for Medicaid must *not* be filed until (1) any period of disqualification has expired; (2) after the look-back period applicable to a disqualifying gift or transfer to trust has run; or (3) for post-DRA transfers, an application must be made to begin the period of ineligibility.

Strategies for Gift-Giving

Obviously, if the individual has no reason to believe that he/she will require nursing home care within the next five years, transferring assets away may make some sense—provided that the pitfalls of doing so are considered. If the individual is already in the nursing home, a careful analysis must be made before assets are transferred.

Transfers of Assets and the Look-Back Rule. There is no law that requires a person in the nursing home to spend all of his/her money on the nursing home, no matter how much, before he/she becomes eligible for Medicaid benefits. Unless the person is adamant about paying his/her own way or has no one to whom to give away his/her assets, no one need pay privately for nursing home care for more than 60 months. This is what the 60-month look-back rule really means.

Income-Only Trust

By setting up an Irrevocable Income-Only Trust, the Medicaid applicant would be both the creator or grantor of the trust, and also the beneficiary of the trust. The trust would pay income only to the trust grantor. This type of trust would provide asset protection; however, a transfer to an irrevocable trust makes the assets unavailable. The result is that the transfer of assets to the trust would subject the Medicaid applicant to a Medicaid transfer penalty.

These trusts are irrevocable, meaning once the funds have been transferred to the trust, the grantor cannot get the money back. The trust funds cannot be withdrawn except as the trustee of the trust is directed according to the terms of the trust.

To avoid the funds in the trust being deemed countable assets to Mrs. Jones under Medicaid law, the trust must not allow the trustee any discretion in distributing principal to her. Distributions of income from the trust, or simply the right to receive income, whether or not distributed, are considered countable.

Special Factors

Make Gifts Last, Not First

We have discussed strategies for transferring assets, whether to a trust or outright gifts. How do transfers of assets fit within the overall strategy of preserving assets?

Income and Nursing Home Costs

These examples above, while complex, still do not consider how much of the individual's income will have to be applied to her nursing home care as well as her actual nursing home costs. For this reason, a careful analysis must be made of these factors before assets are transferred.

Taxes

Gifts that total more than $11,700 million (in 2021) may create liability for the federal gift tax. This is usually not an issue for most people, of course.

Gifts are not taxed as income to the recipient of the gift. The recipient may have to pay income tax on the interest earned on the gifted money, however.

The Gift Letter

For certain large transfers, such as real estate or lump-sum cash amounts, the transferor and the transferee may agree that the gift is subject to a "gift letter." This gift letter attaches "strings" to the gift. The letter says that at anytime during the transferor's lifetime or by a provision in the transferor's Will, the transferor can ask the transferee to surrender the gifted assets to another person (but *not* give them back to the transferor). These strings make the gift incomplete.

Example: Mr. Jones gives his daughter Jane $400,000. They sign a gift letter in which Jane acknowledges that the money does not finally become hers until more than 60 days after Mr. Jones' death and there is no Will that turns within that time that requires her to give up the money in favor of other relatives. Because the money can never legally come back to Mr. Jones, it is subject to the usual Medicaid gifting rules. But because Jane will never finally own the money until after her father dies, the gift is not complete until then, and there is no gift tax.

You should not be overly concerned if you do not fully understand how someone can give something away and not give it away at the same time. The technical term for the gift letter is "reservation of a limited (or special) power of appointment." It is a useful tool in estate tax planning, and in our asset protection planning it can also be useful.

Non-Disqualifying Transfers

Not all gifts or transfers result in Medicaid ineligibility. Under some circumstances, a gift or transfer of assets does not result in the imposition of a period of Medicaid ineligibility. A period of Medicaid ineligibility will not be applied to transfers of resources:

- That occurred more than 60 months prior to the date of the Medicaid application (this is the Medicaid look back period discussed above);
- Where the transfer is for a purpose exclusively other than to qualify for Medicaid;
- Where the transferred assets are returned.
- Where imposition of a Medicaid transfer-of-assets period of ineligibility would cause undue hardship;
- That were intended by the transferor to be for fair market value;
- To a spouse, or to a third party for the sole benefit of the spouse;
- From a spouse to a third party for the sole benefit of the spouse;
- To a blind child, or to a child who is permanently and totally disa-

bled, or to a trust established solely for the benefit of such child; or

- To a trust established solely for the benefit of a disabled person under the age of 65 (who could be a spouse, a child, a relative, or even a stranger).

Medicaid treats the transfer of the individual's home specially. In addition to the previously listed exceptions, there is no period of Medicaid ineligibility imposed when the principal residence is transferred to:

- The individual's spouse;
- A child under the age of 21;
- A child (of any age) who is blind;
- A child (of any age) who is permanently and totally disabled;
- A sibling who has an equity interest in the residence and who resided in the home for at least a year prior to the applicant's institutionalization; or
- A child who resided in the home for at least two years prior to the applicant's institutionalization and who provided care to the individual, thereby permitting the individual to remain at home instead of going to a nursing home. Documentation of residency and care must be provided.

Congress has authorized a disabled person to transfer his or her assets to two special types of trusts and be eligible for Medicaid. A Medicaid ineligibility period will not be applied to transfers of the individual's own funds to a:

1. Trust established by the disabled individual, a parent, grandparent, guardian, or court for the benefit of an individual under the age of 65 who is disabled under the Social Security law.
2. Trust established by the disabled person, parent, grandparent, guardian, or court for the disabled person, where the trust is made up of pooled funds and managed by a non-profit organization for the sole benefit of each individual included in the trust. This type of trust is known as a "pooled" trust.

The trust must not contain any language that requires the trustee to make any payments for the support of the beneficiary. Instead, the funds in the trust can be used only for the disabled person's "supplemental needs" (for non-support items, that is). Moreover, for each of these two types of trusts, the trust must provide that the State receive any funds, up to the amount of Medicaid benefits paid on behalf of the individual, remaining in the trust when the individual dies. That's why these trusts are often called "Medicaid Pay-Back Trusts."

In 2000, the Elder Law Practice created a pooled trust, called the Vista Points Pooled Trust, that some of our clients have used to shelter their funds for their "supplemental needs" or "special needs" and yet still be eligible for Medicaid benefits. This trust is managed by an independent trustee through a not-for-profit corporation named Vista Points, Inc.

In appropriate circumstances, these exemptions from the Medicaid penalty rules can create excellent planning opportunities.

Giving away property in order to qualify for Medicaid is often not a good idea. Here are a number of reasons why.

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1. If the transferred property has a low tax basis (for example, it's a home on the lake bought 40 years

ago for $20,000, and it's now worth $300,000), the transfer is subject to a carryover basis and will result in the transferee's paying significant capital gains tax in the future. (At least this result can usually be avoided if the gift is properly structured.)

2. Giving away assets may create problems with creditors. This is usually not a problem for elderly persons, who are often debt-free. But if the transferor owes money to creditors, and as a result a bank or other creditor is unable to collect a debt, the transfer can be canceled. In some circumstances, such a transfer is considered fraud.

3. The transfer may create a windfall for the transferee's creditors. Children and other transferees (and their spouses) often have debts. The amount transferred is subject to the debts of the transferee. An unexpected or unforeseen calamity befalling the transferee, his or her spouse or a legal dependent will jeopardize the safety of the transferred assets. What if the transferee has a catastrophic illness or is adjudged at fault in causing a serious automobile accident? The transferred assets could be gone.

4. If a child or other transferee divorces, the transferred assets in his or her hands may be subject to distribution by the divorce court or affect that adult child's obligation to pay alimony or child support.

5. The person to whom the assets are transferred may squander the assets. There is no legal obligation of the transferee to retain those assets for the transferor's benefit. It is not unknown for a trusted child or relative to spend assets in ways that the parent would never have anticipated.

6. If the adult child to whom assets are transferred has a child in school, the amount of student aid the child is receiving may be reduced or eliminated.

7. If the adult child to whom assets are transferred is in a higher tax bracket than the transferor, the income earned on the gift is taxed at a higher rate.

Lastly, the psychological effect that the gifted assets may have on the person giving the assets away and the person receiving the assets should be considered.

Example: Mrs. Jones is living independently in her own home. She has $80,000 in her savings account, and she receives $1200 a month in Social Security income, which pays her monthly expenses. Her children convince Mrs. Jones to give them all of the money in her savings account, because they tell her, she "might need to go to a nursing home someday." Mrs. Jones does so, and now she feels impoverished. She has no money and regards herself as dependent on her children.