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Medicaid and Asset Preservation: The Homestead and Estate Recovery

The Homestead Exemption

The home is an exempt asset for Medicaid purposes. This means that it is not counted as an asset for the purpose of determining eligibility for Medicaid. A person with a paid-for home that has a value of up to $636,000 could be eligible for Medicaid if all of the other resources tests were met.

Medicaid Estate Recovery: A "Deferred Countable" Asset

There is a downside to owning a home. Under the Medicaid law passed in 1993, the government must seek repayment of Medicaid funds paid out for nursing home care after the death of the institutionalized person. This is called *estate recovery.* The government gets repaid from assets owned by the institutionalized person at his or her death. In most cases, the only such asset will be the home. The government cannot put a lien on the house and sell it, however, until the death of the Medicaid recipient or recipient's surviving spouse (if any, of course), and only at a time when the recipient has no surviving child who is under the age of 21, blind or disabled.

The result is that the countability of the home is merely deferred to a later date, once the above conditions are met. A person who has sold his/her home may have transformed an exempt asset (the house) to a countable asset (the cash sale proceeds), but the benefit of retaining the home and accelerating Medicaid eligibility only to lose all or a portion of the house to estate recovery years later can be illusory.

In short, if the individual receives Medicaid benefits, his/her home will be subject to estate recovery after his/her death. Although we know that in the past Tennessee state government has been less than zealous in pursuing estate recovery, changes made in 2002 to the state TennCare and Medicaid law have resulted in more money being recovered from the estates of deceased Medicaid recipients.

Many of the strategies discussed in the memo "Asset Preservation Strategies" can be applied to saving the home from Medicaid estate recovery.

The Home as a Burdensome Asset

There are other downsides to retaining the home. Real estate that is no longer occupied, either by the owner or a family member as a homestead or by a tenant who pays rent, is a burden. Utilities and taxes and insurance must be paid, upkeep and maintenance done, and the home kept safe from vandals and other calamities. These circumstances can make the home a burden, unless there really is a realistic chance that the owner will be able to return home someday from the nursing home.

Most of our families, therefore, do not want to retain the home unless the burden of

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ownership can be alleviated or shifted to someone else. The most obvious way to do this is to sell the home.

Selling the Home

When, if ever, does it make sense a single individual to convert an exempt asset (the home) into a countable asset (the cash sale proceeds)? If the home is sold while owner is receiving Medicaid nursing home benefits, the sales proceeds would be countable. This amount would have to be reduced to $2000 in order for the owner to resume getting Medicaid.

If the person has been receiving Medicaid benefits for a lengthy period of time, it may make sense to sell the house and transfer away the money, even if the result is a period of ineligibility. More may be saved by paying privately during the period of Medicaid ineligibility than what will be lost from estate recovery.

Example: Mrs. Jones has been residing in the nursing home and receiving Medicaid benefits for seven years. She is in very poor health and is not likely to live for more than another year. The only asset she owns is her home, which is worth $90,000. Mrs. Jones sells her house for $90,000 and begins paying the nursing home privately until her death nine months later. She pays out $30,000 from the $90,000 over that nine months, leaving $60,000 to her children at her death.

The government will probably have paid out over $200,000 in Medicaid for her during the past seven years. Had she not sold the house, upon her death the government would have recouped out of the house all of the Medicaid benefits it paid out on her behalf. There would be nothing left for her children to inherit.

For persons who have just entered the nursing home, whether it is wiser for the nursing home resident to rent out the house or sell unfortunately depends on a rather morbid calculation of his or her life expectancy.

Selling could be successful where a long nursing home stay is anticipated: The longer the nursing home stay, the more Medicaid pays out for nursing home care, the more Medicaid will be reimbursed out of the house on estate recovery.

If a short nursing home stay were anticipated, selling the home may result in a longer ineligibility period. In such a case it may be wiser to retain the home and utilize other strategies for protecting the home.

Protecting the Home from Medicaid Estate Recovery

As discussed above, while the home is considered an exempt asset for Medicaid eligibility purposes, after the death of the Medicaid recipient, the property is subject to estate recovery. Here is a summary of the strategies for protecting the probate estate of the Medicaid recipient from estate recovery:

1. Have a qualifying family member establish the property as his or her homestead and then plead hardship if the State files a Medicaid estate recovery claim after the Medicaid recipient's death.
2. Transfer or restructure title to the property and pay privately until the penalty period (if any) runs out.
   a. Outright transfer to disabled or blind child of any age is a non-disqualifying transfer.
   b. Outright transfer to caregiver child, with substantiated documentation, can be a non-disqualifying transfer.
3. Sell the property and pay privately if necessary, until our Plan for pre-

serving the countable assets results in Medicaid eligibility.

We'll discuss each of these strategies in this memo.

Strategy No. 1: Transfer or Restructure

Transfer to Community Spouse

If married the Medicaid applicant should transfer his/her interest in the home to the community spouse. The 5 year look back provision would not apply to spousal transfers. When the Medicaid applicant passes away the home is not part of his/her probate estate and not subject to estate recovery.

Transfer to an Irrevocable trust

This is a simple and elegant conveyance from owners/grantors to trustee of an irrevocable trust where the Grantors are not principal beneficiaries. This transfer is subject to a 5 year look back provision but "protects" the home fromm Grantors future long term care costs.

Joint Tenancy

Medicaid applicant/homeowner may deed a percentage of the home to third party and place the home in a joint tenancy with rights of survivorship. This amount can be gifted or sold. If sold for fair market value, then no penalty to be imposed. Because the property will pass to the joint tenant at the death of the other joint tenant via the survivorship interest set forth in the deed, it completely avoids probate and estate recovery.

Transfer with Retained Life Estate and Unlimited Power of Disposition

Many elder law attorneys prefer transferring the home by a quitclaim deed with retained life estate and unlimited power of disposition. (This is sometimes called a "Lady Bird Deed," for reasons unknown to us.) The aim of this planning strategy is to assure:

1. That there will be a step-up in basis for federal income tax purposes.
2. That a completed gift for Tennessee and federal gift tax purposes will not have been made.
3. That no Medicaid transfer of assets penalty will be imposed.
4. That the transferor will be able to remain in the home or have the right to income from the home.
5. That Medicaid estate recovery will be avoided.

Example: Mrs. Jones, 80, owns a home worth $84,000. According to government actuarial tables, the value of the right to use the home for Mrs. Jones' lifetime is 43.66 percent of the home's value, or about $36,450. The remainder interest is therefore worth about $47,550. Mrs. Jones gives the remainder interest to her children and reserves a life estate *and* an unlimited power to dispose of the property during her lifetime. Because she retains the right to sell the property and collect the proceeds, she has not transferred anything of value to her children that she cannot get back.

For this strategy to be effective in Tennessee, therefore, Mrs. Jones must transfer something of value to her children that she cannot get back. This might be a non-exclusive right of use and occupancy of her home, coupled with an agreement that her children maintain her home during her stay at the nursing home until she is able to return home.

Some states do allow use of a Lady Bird Deed, however. Florida is one such state, and our clients who establish a Florida homestead or purchase other exempt real estate in that state may be allowed to use a Lady Bird Deed to avoid estate recovery.

Quitclaim Deed Retaining Limited Power of Appointment

Instead of “splitting” the interest in the home by transferring a remainder interest in it and reserving a life estate, Mrs. Jones could elect to transfer her home to John by a quitclaim deed. This results in the transfer of all her interest in the house to him, but with one exception. It is this exception that makes the gift not subject to federal gift taxes and results in a step-up in basis at the death of Mrs. Jones.

At the time of the conveyance, she and John would execute an agreement in which she retains what is called a “limited power of appointment.” The agreement would provide that Mrs. Jones retains the right at any time prior to her death to transfer the home to someone else by exercising the power of appointment. Thus: “I reserve the right to appoint, in whole or in part, the property conveyed by the deed to or for the benefit of any one or more of my children at any time during my lifetime or by my Last Will and Testament making specific reference to this power of appointment. I cannot, however, appoint the property back to myself or to my estate, or to my creditors or for their benefit [otherwise, for Medicaid purposes, the property would be subject to estate recovery].”

You should think of a limited power of appointment as making a gift to somebody but reserving the right to take the gift out of that person’s hands and place it in someone else’s, such as another family member. It’s a gift but with strings attached.

Why would someone want to do this? The limited power of appointment makes the gift of the home incomplete for federal gift and income tax purposes. The full value of the home will be included in the donor’s estate for federal tax purposes. As a result, the donee receives a full step-up in basis. There are advantages and disadvantages of this arrangement that should be discussed with your elder law attorney.

Private Lending Arrangements

In a private lending arrangement, family members lend funds to the elderly person or couple, who give a mortgage to the lender to secure payment of the debt. If and when the borrower is unable to repay the loan, the debt is called due and the lender accepts a deed to the home in lieu of foreclosure.

This strategy can work particularly well if the family members are already supplementing the elderly person’s income by making gifts.

Reverse Mortgage

If one or both parents are healthy, desire to remain in the home, but need income to do so, still another option for protecting the home is for the parents to obtain a reverse mortgage. Why not a private reverse mortgage?

Children or other relatives would be the lender and the parents the borrower. The value of the home is used as the maximum lien amount. The interest rate on the loan would be the Applicable Federal Rate published by the Internal Revenue Service. The parent or parents grant the children a mortgage.

Example: Mrs. Jones is 80 years old, with an $800 a month income, and a house valued at $120,000. Her monthly expenses are $725, which is an uncomfortably close margin, particularly now that the property taxes are going up in the neighborhood. She enters into a reverse mortgage loan with her two children, John and Jane, for $120,000, the value of her home. On a tenure loan, which pays her income for as long as she lives in the house, her monthly payments might be as much as $586, which would bring her total monthly income

to $1,386. After six years, Mrs. Jones enters the nursing home. As a result, the mortgage loan to her children must be repaid. John and Jane accept a deed in lieu of foreclosure and now own their mother's home outright.

Borrowing Against the Home

In this strategy, a family member extends a secured loan to the elderly person or couple. The loan might be either a lump sum payment or a line of credit against which the borrower draws as desired. Unlike a reverse mortgage, repayment of the loan is not deferred until the borrower dies or moves out of the home. The borrower might pay the debt back in installment payments or in a lump sum at some future time.

The value of the home is used as the maximum loan amount. The interest rate on the loan would be the Applicable Federal Rate published by the Internal Revenue Service. The parent or parents grant the children a mortgage.

Example: Mrs. Jones is 80 years old and owns a house valued at $80,000. She has no countable assets. She faces the likelihood of nursing home care within the next two year. Her two children, John and Jane, extend to her a line of credit for $80,000, the value of her home. Mrs. Jones must repay the entire amount borrowed two years after the line of credit is set up. Mrs. Jones begins drawing money against the line of credit and engages in several of the strategies described in this Plan. After two years, Mrs. Jones enters the nursing home. The mortgage loan to her children must be repaid. John and Jane accept a deed in lieu of foreclosure and now own their mother's home outright.

Strategy No. 2: Transfer Immediately Before Death

A transfer of the homestead will result in Medicaid ineligibility, typically beginning the first of the month following the month in which the transfer is made. So if Mrs. Jones transfers her home to her children on June 15, usually Medicaid stops paying the nursing home on July 1. Technically, she would be ineligible at least starting on June 15, so she might have to pay back Medicaid from June 15 to June 30.

If Mrs. Jones is about to die, however, she could transfer her home to her children. If she dies a few days later, she or her estate might have to pay back Medicaid for the few days. So, if she transfers the home on June 15, and dies on June 16, she might owe Medicaid for two days, but there would be no estate recovery because the home would not be included in her estate. There is nothing for Medicaid to recover.

Who, however, would like to guess on when Mrs. Jones will die? We haven't found many families who would count on this strategy to save the family home from Medicaid estate recovery. Medicaid could allege fraudulent conveyance and still attempt estate recovery.

Strategy No. 3: Sale of the Home

Sale in Exchange for Cash or Promissory Note

One method of protecting the house is to sell the home, either the entire "fee simple interest," a percentage of the home, or its "remainder interest," in the house to children or other relatives. If the owner sells her remainder interest, she retains a life estate in the home—that is, the right to own the house for the remainder of her life. For all intents and purposes, the owner of a life estate still owns the house; by selling her remainder interest, though, she has

given up her right to direct who gets the house after her death.

Example: Mrs. Jones, 80, owns a home worth $84,000. According to the government's actuarial tables, the value of the right to use the home for Mrs. Jones' lifetime is 43.66 percent of the home's value, or about $36,450. The remainder interest is therefore worth about $47,550. Mrs. Jones sells the remainder interest to her children for $47,550. She gives them a deed stating consideration of $47,550 for the transfer and reserves a life estate. Mrs. Jones has free use of the home for as long as she lives. She will continue to pay the taxes and insurance on it. Upon her death, the life estate ends and the home passes to the children.

Sale of the home is structured to give an income stream to the seller.

The sale of the remainder interest in the home is for adequate consideration and therefore not deemed a gift for Medicaid eligibility purposes. The sale of a remainder interest is not eligible for the $250,000 capital gains exclusion, however. Moreover, the buyer's tax basis in the home will not be the full market value of the home but the value of the remainder interest.

If Mrs. Jones enters the nursing home, she retains the right of occupancy of her home. Any rental income obtained during her absence from the home would be applied to her nursing home bill.

To accelerate Medicaid eligibility, the owner of the home may not want to take a cash payment but a promissory note. The amount that the buyer pays is based on a market appraisal conducted by a qualified real estate agent or appraiser or the assessed value according to the county property tax assessor. The value of the seller's retained life estate is based on the government's life estate and remainder interest tables. If the seller enters the nursing home while still receiving note payments, the income from the promissory note would be applied to her nursing home bill.

There are several advantages to selling the home to children or other relatives in exchange for a promissory note:

- The seller is relieved of the burden of home ownership.
- The seller receives an income stream, for life.
- Part of the consideration given by the buyer for the home might be services, as a caregiver or a nursing home advocate.
- The buyer has a legally enforceable obligation to pay the debt.
- The buyer may be entitled to a deduction for mortgage interest paid.
- If the seller enters the nursing home and does qualify for Medicaid nursing home benefits, the income from the note must be applied to the seller's nursing home bill, thereby reducing the amount of Medicaid benefits the State.

Disqualifying Sale of the Home

Sometimes the best strategy is to sell the home and take steps to protect the countable, cash sales proceeds.

Example: Mrs. Jones owns a home and 35-acre farm on one tract of land. She cannot maintain it anymore, and none of her family, including Mrs. Jones, is interested in keeping it in the family. Mrs. Jones sells the farm to her next-door neighbor for fair market value.

Strategy No.5: Hardship

Medicaid won't pursue estate recovery—or claims it may not pursue estate recovery—if the home of the deceased benefit recipient is now the home of a qualifying family member. Remember that Medicaid is pro-

hibited by law from recovery when there is a surviving spouse, minor child, or disabled child, whether or not the survivor lives in the home, so we're not referring to that situation.

TennCare will not recover from an estate when the estate shows that it meets the criteria for an "undue hardship" exception. The "undue hardship" is defined by Tennessee as existing in the following three circumstances:

1. The property of the estate is the sole income-producing asset of the survivors, such as a family farm or other family business.
2. A sibling of the deceased individual meets the following criteria:
    1. He or she was lawfully residing in the individual's home at least 1 year immediately before the individual's admission to the medical institution;
    2. He or she provided care to such individual for that 1 year, which permitted the individual to reside in the home rather than in an institution; and
    3. He or she has lawfully resided in such home on a continuous basis since the date of the individual's admission to the medical institution.
3. A son or daughter of the individual meets the following criteria:
    1. He or she was lawfully residing in the individual's home for at least 2 years immediately before the individual's admission to the medical institution;
    2. He or she provided care to such individual for those 2 years, which permitted the individual to reside at home rather than in an institution; and
    3. He or she has lawfully resided in such home on a continuous basis since the date of the individual's admission to the medical institution.

Note: For purposes of #2 and #3 above, the undue hardship shall be considered to no longer exist when sibling, son, or daughter of the deceased individual, as applicable, no longer resides in such home.

For any of these undue hardship exceptions to take place, a Request for Release must be submitted to TennCare. TennCare will then determine whether the estate is eligible for the undue hardship exception

and, if so, TennCare will file a Release in Probate Court.

You can probably figure out by now we are not persuaded that hardship is a very good strategy to rely on.

Changes in the Law

Federal and state law, rules and regulations change regularly, particularly the laws and interpretation of laws pertaining to Medicaid. The discussion and strategies set forth in this Memorandum are based upon what we know or believe conform to current Medicaid law. Strategies that may be wise if implemented today, however, may be unwise tomorrow, or even unavailable or unlawful, due to changes in the law or interpretations of existing law.