How the Deficit Reduction Act of 2005 affects Medicaid Recipients

This article was written by Monica Franklin, and included in the May 2006 issue of the Tennessee Bar Journal.

On Feb. 8, President Bush signed the Deficit Reduction Act of 2005 (DRA).[1] This law contains several important changes to Medicaid rules, which may trap the unwary lawyer and client.

For example, assume that John Fifty-Something gives $12,000 to each of his four grown children in 2006. John then suffers a stroke and for three years he pays for care at home and an assisted living facility. He then needs nursing home care. Mr. Fifty-Something has spent all of his money on his care, yet when he applies for Medicaid, he learns that he will not qualify for more than a year.

Why? Mr. Fifty-Something gave away $48,000 four years ago when times were good, and he was healthy. Now, his children, who have long-since spent that money, learn that they must find a way to pay for Dad's care. Why? Read on.

Will the DRA 2005 affect your clients? Will it affect you or your family? Here are some worrisome statistics: one-half of our population will need long-term care at some point in their lives and about 40 percent of those who need long-term care services are of working age.[2] Eighty-three percent of Tennessee long-term care patients receive Medicaid to pay for their care.[3] Chances are that changes in the Medicaid rules will affect your clients or (gasp!) your family. This article contains a summary of crucial changes that will affect anyone who may need Medicaid assistance to pay for long-term care.

1. The look-back period is longer.

The look-back period has been stretched from 36 to 60 months. Prior to the DRA 2005, a Medicaid applicant was only required to reveal transfers that occurred during the 36 months preceding the Medicaid application. (The look-back was 60 months for transfers to and from a trust.) The DRA 2005 requires the patient to reveal all

transfers made during the 60 months preceding the Medicaid application, regardless of whether the transfers were to/from a trust or otherwise.
2. Calculation of the penalty period for gifts has changed.

When a person transfers an asset for less than fair market value during the look-back period and then applies for Medicaid, the Department of Human Services will impose a penalty period. This is a time of ineligibility during which the patient must pay for his care from his funds. Medicaid will not pick up the tab during this time. Under prior law, the penalty period began ticking on the date of the gift.

The penalty period for a gift or other transfer of an asset for less than fair market value now begins ticking on the date when the Medicaid applicant needs long-term care services, applies for Medicaid and would be eligible "but for" the gift. In other words, the penalty period for gifts during the five years before the Medicaid application will begin only after Granny is in a nursing home,[4] her assets are spent down to $2,000, her monthly gross income is below $1,737 (2006), and she applies for Medicaid.
3. States may not round down when calculating the penalty period.

In order to calculate a penalty period, the Department of Human Services will divide the amount of the gift by $3,394, the penalty divisor for Tennessee in 2006. (These divisors vary from state to state.) Under the old rule, Tennessee "rounded down." Thus, a $12,000 gift divided by $3,394 would yield a penalty period of three months under the old rule. However, the Deficit Reduction Act requires each state to stop this practice. A state may not disregard any fractional period of ineligibility; thus, the penalty for a $12,000 transfer will be 3.5 months.

How will these three changes affect your client? Assume Jane Elder sells her home in May 2006 for $150,000 and decides to give $15,000 to her church. She then purchases a condominium. Three years later, she suffers a stroke and requires long-term care in a nursing home. Jane has spent all of her liquid assets on her needs during the last three years. She has only $1,500 in cash. She believes her circumstances meet all of the financial and medical requirements for Medicaid, so her daughter goes to the Department of Human Services on Jan. 1, 2009, to apply for Medicaid. Daughter

Elder is shocked to learn that her mother will not qualify for Medicaid for 4.4 months (15,000 ÷ 3,394), or about May 15, 2009. Under prior law, the penalty period would have expired four months from the date of the gift. The true cost of Jane Elder's care is $174 per day so that she needs more than $23,000 to cover the actual cost of her care while she waits to be eligible. Who will pay for her nursing home care during that time?

The DRA 2005 provides that each state must make provisions for a hardship waiver process. Tennessee has a hardship provision on the books, but it is rarely used or approved by the Department of Human Services. Under the DRA, an undue hardship exists when application of the transfer penalty would deprive the patient of medical care such that his life or health would be endangered or he would be deprived of food, clothing, shelter or other necessities of life. Now Jane Elder will have to appeal her denial of Medicaid and bear the expense of litigation to prove "undue hardship." The state may even require her to make efforts to recover the transferred asset.[5]
4. The DRA 2005 tightened the rules on annuities.

The state must now be designated as a remainder beneficiary on an annuity held by the nursing home patient and perhaps even the community spouse.[6] In the past, the children were usually designated as the beneficiary on the annuity. Now however, the state must be designated as the primary beneficiary to the extent of medical assistance paid to the nursing home patient. If the nursing home spouse is the annuitant, then the community spouse or a disabled child may be designated in the first position. However, the state may be bumped to first position if the spouse or the child transfers the remainder for less than fair market value.
5. Additional changes under the Deficit Reduction Act of 2005 are:

* States must apply the "income first" rule for the community spouse's support. This rule provides that a community spouse may keep enough of the nursing home spouse's monthly income to bring her up to the Minimum Monthly Maintenance Needs Allowance ($1,604 for 2005). Prior to DRA 2005, a state might allow the community spouse to keep additional assets that would produce enough income to bring her up to the MMMNA. Tennessee was an "income first" state prior to DRA 2005.

* The Medicaid applicant is restricted to $500,000 home equity, which may be increased to $750,000 by the state. In Tennessee, the Medicaid agency determines the value of the home by using the tax assessor's value. While most Medicaid applicants have very modest equity in their homes, some patients are cash poor and land rich. If the tax appraiser's value of the patient's home exceeds $500,000, those patients will not qualify for Medicaid.[7]

* Rules related to Continuing Care Retirement Communities are tightened.

* There are certain restrictions on the use of promissory notes, loans, or mortgages as exempt resources.

* A Medicaid applicant who purchases a life estate in another person's home must actually live in the home for one year after the purchase.

* Expansion of the State Long-term Care Partnership Program is authorized.This program was restricted to four states: California, Connecticut, Indiana and New York prior to DRA 2005. The expansion of this program is a positive measure for healthy folks who can afford long-term care insurance. If Tennessee becomes a partner in the program, a person who buys a state-approved long-term care insurance policy may apply for Medicaid after she has exhausted the policy benefits, but retain assets up to the value of the insurance paid out from the policy. Hopefully, Tennessee will join this partnership program as soon as possible.

This bullet list of changes will probably not affect your clients as drastically as the transfer rules described in this article. In fact, most of the fallout from the Deficit Reduction Act will not be felt until our parents and grandparents learn they will be punished for innocent gifts made before they needed long-term care. The Deficit Reduction Act of 2005 affects only transfers that occur on or after the effective date of the act — Feb. 8, 2006. However, if you give advice about gifts or transfers of property in the future, be sure to include a statement or two about the DRA 2005 and the possible impact if your client needs long-term care.

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Notes

[1] Deficit Reduction Act of 2005, S. 1932, Public Law 109-171; 42 USC §1396p and 1396r-5. A copy of the legislation approved by the Senate and House may be found at http://thomas.loc.gov/. Type S 1932 in the search box. The specific sections referred to in this article are found in the Deficit Reduction Act of 2005, Title VI Medicaid and S.C.H.I.P., Subchapter A-Medicaid, Chapter 2 — Long-Term Care Under Medicaid, Subchapter A — Reform of Asset Transfer Rules, §§ 6011-§ 6016. You may also find more information by searching "Medicaid" on elderlawanswers.com.

[2] This information was gleaned from Tennessee's website: www.state.tn.us/ finance/ins/ltc.html.

[3] Pinto, Claudia, The Tennessean, Jan. 8, 2006, "Nursing Homes Depend on Medicaid But Say It Doesn't Cover All the Costs." This article may be found at www.tennessean.com/apps/pbcs.dll/article?AID=/20060108/NEWS07/601080368/1349/COUNTY. However, the Tennessee Healthcare Association Web site states that 74 percent of Tennessee's long-term care patients depend on Medicaid; see www.thca.org.

[4] The applicant may also be at home and applying for home-based waiver services.

[5] CMS State Medicaid Manual 3258.10.C.5.

[6] It is not entirely clear from the statute as to whether the state must be designated as beneficiary in the first position if the annuitant is the community spouse.

[7] There are techniques to diminish the excess equity or convert the property to another type of exempt asset; however, that subject exceeds the scope of this article.