# Medicaid Planning
# Time of Change

By Douglas G. Chalgian

Times are changing in the world of Medicaid planning. Always a volatile area of the law, Medicaid planning has entered a period in which the changes being implemented are especially significant, and happening more rapidly than at any time in the recent past. New laws and regulations at both the federal and state levels are eliminating old planning strategies and giving rise to new planning techniques.

## April Surprises

Two significant changes to Medicaid eligibility rules took effect April 1, 2007:[1]

### Elimination of the 6 Percent Rental Property Exclusion

Historically, Michigan Medicaid rules have allowed real property to be exempt as long as the property generated rental income of at least 6 percent of the equity value of the property. This exclusion applied to real estate that would not otherwise be exempted as homestead property. Typically, the rental property exclusion provided protection to real estate such as parcels of farmland that were not contiguous with the land on which the farmer's home was located, and for second homes (such as a cottage). The elimination of this planning tool takes away one (relatively simple) method of protecting these types of assets in the context of seeking Medicaid eligibility.

### Elimination of Retroactive Planning with Funeral Contracts

Before April 1, 2007, people applying for Medicaid benefits had the ability to "spend down" retroactively by using prepaid funeral contracts. This rule allowed people to apply for Medicaid benefits in one month and become eligible for up to three prior months if (1) in those prior months, their excess assets were no more than the amount allowed to be sheltered in irrevocable prepaid funeral contracts (currently about $11,000); and (2) they used those excess funds to purchase funeral contracts for themselves or their spouses. This option is no longer available.

## The Deficit Reduction Act of 2005

In July 2007, Michigan adopted new rules to implement the Deficit Reduction Act of 2005 (DRA),[2] a federal law that was signed by the president on February 8, 2006. A second set of rule changes designed to modify and clarify some of the July 2007 rule changes and also to implement additional provisions of the DRA took effect October 1, 2007. Following is a discussion of the significant changes in Medicaid long-term care planning resulting from Michigan's implementation of the DRA.

**Fast Facts:**

**Medicaid financial eligibility rules are changing.**

**New laws and regulations at both the federal and state levels are eliminating old planning strategies and giving rise to new planning techniques.**

### Divestment Changes

For many years, Medicaid rules have penalized people who give away assets or sell them for less than fair market value to become financially eligible for Medicaid benefits. These are the Medicaid "divestment rules." Always a confusing and controversial area of Medicaid planning, the divestment rules are dramatically altered by the DRA:

#### The Look-Back Rule

The period of time that divestments will need to be disclosed is extended from three years before the application to five years before the application. The extension of the so-called "look-back period" will be applied to transfers after February 8, 2006. Transfers before February 8, 2006 will still be subject to the three-year rule.[3]

#### Triggering the Penalty Period

The penalty for divesting assets during the applicable look-back period is ineligibility for a period of time (a "divestment period of ineligibility"). The length of the divestment period of ineligibility that is applied in a particular case is a function of the value of the assets transferred. Specifically, the more assets that are transferred, the longer the divestment period of ineligibility will be. Essentially, the value of the assets transferred is divided by a figure that represents the approximate cost of privately paying for nursing home care for one month (currently about $6,000). The resulting figure is the number of months the individual will be ineligible for Medicaid benefits. The new rules do not change the method for calculating this divestment period of ineligibility. Instead, these rules change the timing of the imposition of the penalty period.[4]

Historically, divestment periods of ineligibility would begin to run from the date of the transfer. Thus, if a person gave away an amount of money that would give rise to a six-month period of ineligibility, seven months later, that penalty would have expired and that person would no longer be ineligible for Medicaid benefits as a result of the divestment. This meant that a person could give away assets before or after entering a nursing home, and provided they did not apply for benefits until the expiration of the resulting penalty period, that person would be able to qualify for Medicaid benefits when the period of ineligibility expired. Under the rules that took effect in October 2007, the period of ineligibility does not begin to run until a person has applied for benefits, and has demonstrated that he or she would meet all of the Medicaid eligibility requirements, and would in fact be eligible for Medicaid benefits, *but for* the imposition of the divestment penalty. This means that before the divestment penalty period of ineligibility begins to run, a person must be in a nursing home (or eligible for nursing-home-level care and have been screened for MI Choice services) and must have "countable assets" of no more than the allowable asset limit.

### Partial-Month Penalties

Before the change, divestment periods of ineligibility were always calculated as whole months. This was accomplished by a rule that required all penalty periods to be rounded down to the nearest whole month. Under the new rules, divestment periods of ineligibility will be calculated to a number of months and days.[5]

### Combining Transfers

All divestments made during the entire five-year look-back period will now be combined before a penalty period of ineligibility is calculated. In the past, the fact that divestments made in separate months have been penalized separately, combined with the fact that penalty periods were previously rounded down to whole months, allowed for a practice of divestment planning commonly referred to as "serial divestments." This practice is no longer viable.[6]

### Extension of Divestment Rules

At the same time the DRA changes are being implemented, Michigan has expanded the application of the divestment rules to Medicaid programs that were not previously subject to these rules. Specifically, the new rules apply divestment penalties to the Medicaid Home Help and Home Health programs.[7]

The changes to the divestment rules are significant. In addition to the elimination of serial divestment as an option, the tradition of having the passage of time cure periods of ineligibility caused by asset transfers of relatively negligible amounts is also gone. Under the new rules, a series of relatively small transfers during the look-back period will be combined and will result in periods of ineligibility. Accordingly, it is now more important to establish that a transfer made during a look-back period was done without any anticipation of needing Medicaid assistance. It is also now more important to have written contracts for family members who are paid for providing care-giving services to an elder before that elder enters a nursing home or applies for Medicaid benefits. Indeed, under Medicaid rules, these payments are presumptively gratuitous unless made in accordance with a contemporaneous written care agreement. When divestment planning is a part of the Medicaid strategy, practitioners need to understand and apply the new trigger rules to obtain desired results. Divestment strategies will remain a major part of Medicaid planning, but the methods have changed, and practitioners need to make sure their advice is consistent with these changes.

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### Annuity Liens

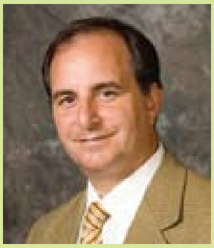
The DRA mandated that the state be named the remainder beneficiary on annuities purchased or modified after February 8, 2007. This requirement was implemented with the changes that took effect October 1, 2007. The rule would mandate that the state be named the primary beneficiary of an annuity, unless a spouse, disabled child, or minor child is primary—in which case the state would be named as the secondary beneficiary. The lien would be for the value of Medicaid benefits provided.

### Homestead Cap

The new rules provide that real estate that would otherwise be an exempt homestead under Medicaid rules (the personal residence and all contiguous land) will not be exempt if the property has an equity value of more than $500,000. "Equity value" is the value of the property reduced by any legally enforceable encumbrances. This represents the first time the value of an exempt homestead has been capped. Pursuant to the DRA, the $500,000 figure will be adjusted annually to account for inflation.

## Conclusion

Medicaid financial eligibility rules are changing. The changes imposed by Michigan in April 2007, as well as the changes mandated by the DRA, are likely to be only part of the changes that planners will face in the months and years to come. Not surprisingly, as quickly as the rules develop, new planning techniques are being developed and shared among attorneys who practice in this area. While these changes are dramatic, attorneys should not be led to believe that they will eliminate, or even reduce, the need for qualified advice to clients in situations in which Medicaid planning is appropriate. If anything, the need for qualified planners in this area is only heightened by these developments. ■



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FOOTNOTES

1. Michigan Department of Human Services, *Program Eligibility Manual Item 400* <http://www.mfia.state.mi.us/olmweb/ex/pem/400.pdf> (accessed September 26, 2007).
2. Deficit Reduction Act, PL 109-171, 120 Stat 4.
3. 42 USC 1396p(c)(1)(B)(i).
4. 42 USC 1396p(c)(1)(D).
5. 42 USC 1396p(c)(1)(H).
6. *Id.*
7. See n 1, *supra.*

## Michigan Adopts "Probate Only" Estate Recovery Law

On October 1, 2007, Michigan adopted an "estate recovery" law (Public Act 74 of 2007).

Estate recovery means that people who receive Medicaid benefits for nursing-home-level care may be responsible for repaying the state for the costs of their care after they die. Typically, that means a claim against the home of the Medicaid beneficiary.

Before passage of the bill, Michigan was the only state in the nation that did not have such a law. Since 1993, the federal government has required all states to have an estate recovery law. Michigan has been out of compliance with that federal law since that time. Shortly after her election, Governor Granholm signaled a strong desire to impose this law on Michigan residents.

On a brighter note, the law, as adopted, provides many protections and opportunities to avoid the potentially harsh impact of estate recovery. The key elements of the law are:

1. It applies only to the probate assets; assets in revocable trusts are expressly not reachable. Assets that pass by joint ownership, beneficiary designations, payment on death designations, and life estates, would also not be reached by estate recovery.
2. If assets are in the probate estate, the following exemptions are applied:
   a. Family farm, business, or other "income producing assets" are exempt if they are the "primary" source of income to the "survivors."
   b. If the homestead is subject to estate recovery, recovery applies only to that portion of the value that is above 50 percent of the average price of a home in the county in which the home is located.
   c. The homestead is completely exempt from recovery if occupied by the spouse or child (blind, disabled, or under age 21) of the Medicaid recipient [although there is language in the law that might allow a claim to be made when the spouse dies—if he or she leaves property in a probate estate].
   d. The homestead is completely exempt from recovery if occupied by a relative of the Medicaid recipient (within fifth degree of kinship) and if that relative provided care to the Medicaid beneficiary for at least two years, thereby keeping the Medicaid recipient deinstitutionalized.
   e. The homestead is exempt from recovery if the Medicaid recipient's sibling is a joint owner and lives in the home.
3. Any recovery is capped at actual costs of Medicaid medical services paid for on behalf of the Medicaid recipient, without interest.
4. No estate recovery program will be implemented until "approval of the federal government is obtained."

The passage of estate recovery in Michigan, and resulting publicity, can be expected to (1) raise clients' concerns that their estate plans are set up to address the potential exposure of their assets to estate recovery, and (2) increase activities of unscrupulous characters who will use news about estate recovery as another "scare tactic" to market financial and legal products. Estate planning attorneys should be prepared to explain the nature of Michigan's estate recovery law to their clients, and assist them in implementing sound planning strategies in response.