

# **MEDICAID COMPLIANT ANNUITIES A WISCONSIN APPROACH 2008 AND BEYOND**

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## **BIOGRAPHY**

### **DALE M KRAUSE, J.D., LL.M.**

For more than 20 years, on a national level, Dale M. Krause, J.D., LL.M., has provided Medical Assistance (“MA”) Compliant Annuities to elder law attorneys, and their clients. As a result of his practice, Mr. Krause has been labeled “The Pioneer of Medicaid Compliant Annuities.”

Mr. Krause is the Chief Executive Officer of Krause Financial Services, a business that designs, develops, markets, and distributes MA compliant products. Mr. Krause earned his B.S. degree from the University of Wisconsin-Stevens Point, in 1981, his J.D. degree from Thomas Cooley Law School, of Lansing, Michigan, in 1985, and his LL.M. in Taxation from DePaul College of Law, of Chicago, Illinois, in 1990. He is a practicing member of the Wisconsin and Michigan Bars, and is an out-of-state member of the New York Bar Association. He is a licensed insurance agent in all fifty states, and is also registered to sell stocks, bonds, and mutual funds.

Mr. Krause is a regular speaker and educator at continuing legal education forums throughout the United States. In addition to his notable affiliations, including: National Academy of Elder Law Attorneys, Inc., Academy of Special Needs Planners, ElderLawAnswers, Florida Legal Education Association, Medicaid Practice Systems, American Association of Attorney-Certified Public Accountants, and WealthCounsel Advisors Forum, Mr. Krause’s work and experience has also been recognized in major publications, including: Senior Market Advisor, NAELA News, The Wall Street Journal, and Lawyers Weekly USA.

As a result of his national sales, Mr. Krause has achieved some of the top honors in the insurance industry, including the “Top of the Table” (highest distinction) with the Million Dollar Round Table – The Premier Association of Financial Professionals, for 2007 and 2008. Additionally, Mr. Krause has been recognized by Lincoln Financial Group, as a 2008 Premier Partner. Furthermore, Mr. Krause has achieved President’s Club status for 2008 with Employees Life Company (Mutual), a leader in MA Compliant Annuities.

## **PREFACE**

With my February 26, 2008, presentation to the Milwaukee Bar Association being limited to MA compliant annuity planning, the general aspects of Wisconsin's MA Program will not be covered by this outline.

## **DISCLAIMER**

Dale M. Krause, and Krause Financial Services, by means of this outline, is not offering legal advice. With respect to the material contained in this outline, some of the material may be affected by current and future changes in MA law. For those reasons, the accuracy and completeness of such information, and the opinions of its author, are not guaranteed. In addition, because of the complexity and interrelationship of various areas of law which are presented in this outline, from which there may be certain exceptions or limitations, the strategies and plans outlined in this outline may not be suited for every individual in Wisconsin. As such, it is strongly suggested that before employing any one, or more, of the techniques, strategies, expositions of any law, the reader should secure the services of an elder law attorney in Wisconsin, whose practice includes significant MA planning.

## INTRODUCTION

With two years having passed since President Bush signed the Deficit Reduction Act of 2005 (“DRA”) into law, to the exclusion of Wisconsin, 39 states have passed the required DRA legislation. As we all know, the primary purpose of the DRA legislation is to curb federal spending. Within the DRA legislation, Congress modified MA rules and statutes. As a result, elder law attorneys have had to change the way they conduct their MA planning practices, in that some of the well known MA planning techniques and strategies were either curtailed or eliminated by the DRA legislation.

## THE TWO BASIC TYPES OF ANNUITIES

The two basic types of annuities are deferred and immediate. A deferred annuity is an investment that an individual makes with an insurance company. The advantage of a deferred annuity, unlike many other investments, such as a certificate of deposit, is that the investment grows income tax deferred; thus, the investment grows at a faster rate. However, with the investment value of the tax deferred annuity being readily available to the individual<sup>1</sup>, the investment is considered a countable resource for MA purposes. On the other hand, an immediate annuity is not considered a countable resource. The reason for this relates to the fact that the individual does not have the ability to access the investment value; similar to a pension, where the individual only has access to a monthly income, the immediate annuity is treated only as an income stream for MA purposes.

**Practical Point:** A tax-deferred annuity can be converted into an immediate annuity, while an immediate annuity can never be converted into a tax-deferred annuity.

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<sup>1</sup> If a tax deferred annuity was recently purchased, in the event of a total withdrawal, the individual will be subject to an applicable surrender charge, thus reducing the value of the annuity.

## THE PARTIES TO AN MA ANNUITY

There are five parties to an MA annuity, including:

**1. Issuer**

The issuer is the insurance company and is the party that accepts the premiums and promises to pay the payments scheduled within the MA annuity.

**2. Owner**

The owner is the party who controls the MA annuity.

**3. Annuitant**

The annuitant is the party who is the measuring life in a tax deferred annuity.

**Note:** Once a tax deferred annuity is converted to an MA annuity, or an MA annuity is purchased directly from the insurance company, the annuitant is no longer a necessary party in that the MA annuity has a specified term of payments.

**4. Payee**

The payee is the party who receives the payments from the MA annuity.

**5. Beneficiary**

Following the death of the owner, the beneficiary is the party who receives any residual payments from the MA annuity. MA annuities typically have a primary beneficiary – the first party to receive any residual payments, and a secondary beneficiary – who may, or may not, receive any residual payments.

**Practical Point:** With most MA annuities, the annuity will be structured with the owner, annuitant, and payee being the same person.

## FEDERAL HISTORY OF MA ANNUITIES – PRE DRA

MA Annuities were first addressed by the Omnibus Budget Reconciliation Act of 1993 (“OBRA”)<sup>2</sup>. OBRA provided that “annuities may be treated as trusts to the extent and manner specified by the Secretary of Health and Human Services”. However, the Secretary chose not to treat annuities as trusts, and continued to allow annuities to be used in MA planning. Furthermore, in order to clarify the annuity rules of OBRA, the Healthcare Financing Administration (HCFA), which is now known as the Centers for Medicare and Medicaid Services (“CMS”), issued Transmittal 64 in November of 1994. Within Transmittal 64, an immediate annuity was defined as an unavailable resource when the owner/annuitant could show that his or her entire investment would be returned within his or her MA life expectancy. That test was referred to as the “actuarially sound test”. Additionally, in order to determine the appropriate MA life expectancy, Transmittal 64 proscribed gender based life expectancy tables<sup>3</sup>. Since the implementation of OBRA and Transmittal 64, many states, including Wisconsin, have supplemented the federal rules and regulations with some of their own MA provisions.

## WISCONSIN HISTORY OF MA ANNUITIES – PRE DRA

On February 1, 2008, the Wisconsin Medicaid Eligibility Handbook (“MEH”) was updated by way of Release 08-01. Within the MEH, MA annuities are addressed in the following Sections: 16.7.4, entitled “Annuities”; 17.11, entitled “Annuities”; and Appendix 39.8, entitled “Life Expectancy Table”. For a complete copy of the aforementioned sections, please see Exhibit A attached to this outline.

**Practical Point:** In order to meet the regulations outlined in Release 08-01, a MA annuity must be structured with equal payments that are scheduled over the

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<sup>2</sup> The OBRA legislation was passed in August of 2003.

<sup>3</sup> See §3258.9(B) of Transmittal 64.

owner/annuitant/payee's MA lifetime. The MA annuity contract must also contain language which makes it irrevocable, and non-assignable. Finally, in support of its non-marketability on the secondary market, the MA annuity must be supported by three refusal letters.

## FEDERAL HISTORY OF MA ANNUITIES – POST DRA

With the passing of DRA, three major changes impacted MA annuities. The changes included:

### 1. Remainder Beneficiary

The purchase of an MA annuity will be treated as a divestment unless the State is named as “remainder beneficiary in the first position for at least the total amount of medical assistance paid on behalf of the annuitant...”, or is named as second beneficiary after the community spouse or minor or disabled child...<sup>4</sup>.

**Note:** On December 20, 2006, by way of the “Tax Relief and Health Care Act of 2006” (“TRHC 06”), Congress struck out the word “annuitant” in the DRA annuity reform provisions, and replaced it with the words “institutionalized individual”. Additionally, TRHC 06’ stated that the technical correction was retroactive to the implementation of DRA – February 8, 2006.

### 2. Availability

An MA annuity is treated as an asset “of an annuitant who has applied for medical assistance” for long-term care unless (a) it is an individual retirement annuity or purchased with the proceeds from certain retirement assets, or (b) the MA annuity is irrevocable and nonassignable, is actuarially sound, and provides for equal payments with no deferral or balloon payments<sup>5</sup>.

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<sup>4</sup> See DRA §6012(b); 42 U.S.C. §1396p(c)(1)(F)

<sup>5</sup> See DRA §6012 (c); 42 U.S.C. §1369p(c)(1)(G)

### **3. Disclosure**

At the time of an MA application, or MA recertification, the MA applicant, and his or her spouse, if applicable, must disclose any interest in a MA annuity. Additionally, the State MA program may notify the issuer/insurance company of its position as a preferred beneficiary and may require the issuer to notify it when there is a change in amounts being withdrawn from the MA annuity.

### **DRA ANNUITY REGULATIONS – WISCONSIN – OPINION**

In light of the current MA annuity planning strategies used in Wisconsin, and assuming the Wisconsin MA Program adopts the DRA regulations in the near future, and based on what post DRA states have already accomplished, I am of the opinion that MA annuities will still provide a viable MA planning opportunity for those individuals, and couples, who are faced with a MA spend-down.

### **MA ANNUITY PLANNING FOR A MARRIED COUPLE**

In the case of a husband and wife, a MA annuity will provide an excellent result. For purposes of an example, assume the following facts:

***PowerPoint Slides:*** *The following example is illustrated in PowerPoint slides 14 through 19, which have been attached to the end of this outline and marked as Exhibit B.*

**Case Facts:** George and Janet Smith are both age 85. After a long struggle with Parkinson's disease, George entered a nursing home in February of 2008. He and his wife have a home, standard furniture and personal property, one car, and \$200,000.00 in non-IRA bank accounts. George has monthly income from social security and pension of \$1,200.00, and Janet receives only social security benefits of \$500.00.

The nursing home bill is expected to average \$6,000.00 per month. In light of this fact, Janet would like to immediately qualify George for MA benefits.

**MA Annuity Plan:** With George and Janet having total countable resources of \$200,000.00, and a spend-down amount of \$98,000.00, Janet will need to purchase a MA annuity with the spend-down amount. With Janet being 85 years of age, and having a MA life expectancy of 107 months, the MA annuity will pay her \$957.52 per month. If Janet purchases the MA annuity in February of 2008, which immediately eliminates the spend-down amount, George will become immediately eligible for MA benefits. As a result, in February of 2008, George's MA co-pay is \$0.00. Additionally, in March of 2008, and each month thereafter, George's MA co-pay is \$330.85.

**Economic Results:** With George and Janet expecting to pay \$6,000.00 per month for George's nursing home care, by qualifying for MA benefits in February of 2008, and having a MA co-pay of \$0.00, Janet and George will experience a total savings in that month. In March of 2008, and each month thereafter, when George's MA co-pay increases to \$330.85, Janet and George will experience a \$5,669.15 savings on George's monthly nursing home care costs.

## **MA ANNUITY PLANNING FOR AN INDIVIDUAL – NO COMMUNITY SPOUSE**

In the case of an individual MA applicant, with DRA eliminating the use of a Balloon Style MA annuity, the individual will have two MA annuity planning opportunities:

**Short Life Expectancy Case:** If the individual has a very short life expectancy, in light of his or her MA life expectancy, a MA annuity, by itself, will provide the best economic result. For purposes of an example, assume the following facts:

**Case Facts:** Janet Smith, a widow, is age 85, and has been given 12 months to live. Presently, she is in a nursing home receiving custodial care at a monthly cost of \$6,000.00. The MA rate for the nursing home is \$4,200.00. After purchasing a pre-paid funeral plan, some personal property, and setting aside \$2,000.00 in her checking account, Janet has a spend-down amount of \$134,900.00.

**MA Annuity Plan:** In order to gain immediate MA eligibility, Janet purchases a MA annuity with the \$134,900.00. The MA annuity is structured with 107 monthly payments of \$1,318.05. As a result of the MA annuity purchase, Janet becomes immediately eligible for MA benefits, and her monthly MA co-pay to the nursing home is \$2,808.05<sup>6</sup>. This amount was determined by totaling her monthly income from Social Security, pension, and her MA annuity, and reducing it by her \$45.00 monthly personal needs benefit.

**Economic Results:** If Janet dies in month 12, with the Wisconsin Department of Health and Family Services (“DHFS”) named as the primary beneficiary of her MA annuity, DHFS will be looking to collect \$16,703.40<sup>7</sup> for Janet’s MA room and board costs. With Janet’s MA annuity having 95 monthly

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<sup>6</sup>  $(SS/\$1,050.00 + Pension/\$485.00 + MA\ annuity/\$1,318.05) - Personal\ Needs\ Allowance/\$45.00 = \$2,808.05.$

<sup>7</sup> This amount was determined by reducing the monthly Medicaid/MA reimbursement rate by Mrs. Smith’s monthly Medicaid/MA co-pay, and multiplying the result by 12 months. In addition to the Medicaid/MA room and board costs, DHFS will also be looking to collect for Mrs. Smith’s Medicaid/MA prescription drug costs.

payments remaining - \$125,214.75, less the \$16,703.40 owed to DHFS, Janet's children, as the secondary beneficiary of her MA annuity, will receive \$108,511.35 in residual monthly payments. As a result, the stand-alone MA annuity Plan provided an excellent opportunity for Janet to transfer wealth to her children.

**Long Life Expectancy Case:** If the individual has a longer life expectancy, in light of his or her MA life expectancy, a Gifting/Short-Term MA Annuity Plan will provide the best economic result. For purposes of example, assume the following facts:

**PowerPoint Slides:** *The following example is illustrated in PowerPoint Slides 22 through 26, which have been attached to the end of this outline and marked as Exhibit C.*

**Case Facts:** Janet Smith, a widow, is 85 years of age. After a long struggle with Parkinson's disease, Janet entered a nursing home in February of 2008. Janet has limited furniture and personal property, and \$136,900.00 in savings accounts. Janet has a monthly income from social security and pension of \$1,100.00. Her nursing home bill is expected to average \$6,000.00 per month. Janet would like to qualify for MA benefits as soon as possible.

**MA Annuity Plan:** With the Gifting/Short-Term MA Annuity Plan, Janet would immediately gift away \$71,866.08 of the \$134,900.00 spend-down amount. The immediate gift amount would create a 12.87 divestment penalty period<sup>8</sup>. As for the remaining spend-down amount of \$63,033.92, it would be immediately invested in a

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<sup>8</sup> When \$71,866.08 gift amount is divided by Wisconsin's Monthly Divestment Penalty Divisor of \$5,584.00, the result equals a 12.87 month divestment penalty period.

13 Month MA annuity<sup>9</sup>, which would pay Janet \$4,876.97 per month. Following the gift, and the purchase of the MA annuity, Janet would immediately apply for Wisconsin MA benefits. With Janet being “otherwise eligible”, except for the divestment penalty period, she would be entitled to go on economic MA benefits following the final monthly payment from her 13 Month MA annuity.

**Economic Result:** With the Gifting/Short-Term MA Annuity Plan Plan, Janet’s children will retain the gift amount of \$71,866.08. This is an excellent result in light of the fact that had Janet not done any MA planning, she would have exhausted her \$134,900.00 spend-down amount in 27.53 months<sup>10</sup>.

**Note:** If an individual is expected to live well beyond his or her MA life expectancy, he or she would not want to proceed with a stand-alone MA annuity. The reason for this relates to the fact that if he or she lives for the entire duration of his or her stand-alone MA annuity, all of the monthly income from the MA annuity would have been contributed to the nursing home – no opportunity for a wealth transfer.

**Practical Point:** In light of the delay of DRA being implemented in Wisconsin, the safest course of action for elder law attorneys is to develop MA annuity plans based on the DRA legislation.

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<sup>9</sup> With MA annuities being issued in whole months, it is not possible to issue an MA annuity with a period certain of 12.87 months. Instead, a 13 month MA annuity will be issued.

<sup>10</sup> This amount was determined by reducing the \$6,000 monthly nursing home cost by Mrs. Smith’s monthly Social Security and pension income of \$1,100.00 and dividing the net result into the \$134,900.00 spend-down amount.

## **CONVERTING AN IRA ACCOUNT INTO AN MA ANNUITY**

If an individual already has an existing IRA account, such as a certificate of deposit, mutual fund, or money market account, and wants to transfer the proceeds into an IRA MA annuity, he or she can do so by way of a “plan administrator to plan administrator transfer” or “60 day rollover”. The aforementioned MA strategy would only apply to IRA accounts in the institutionalized individual’s name.

## **CONCLUSION**

Despite the enactment of the DRA, and the curtailment and elimination of some well known MA planning strategies, MA annuities will still provide a reasonable MA planning opportunity to those individuals looking to qualify for MA benefits.