

**Using Annuities in Medicaid Planning – Post DRA
A Kansas Approach**

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BIOGRAPHY

Dale M. Krause, J.D., LL.M.

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

Mr. Krause is the founder and CEO of Krause Financial Services, a business that has been in existence since 1990. 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 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.

On a national basis, Mr. Krause is a regular speaker and educator at continuing legal education forums. 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, American Association for Long-Term Care Insurance, 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.

In 2006, with commercial insurance companies not offering Medicaid Compliant Annuities (“MCA”) within the range of 2 to 23 months, Mr. Krause was instrumental in establishing Krause Annuity Services, Inc., a Wisconsin corporation, designed to meet the new MCA demands. In addition to Medicaid Compliant Annuities, Krause Financial Services, Inc., offers other Medicaid compatible products including: Single Pay Nursing Home Insurance – with a full return of premium rider, DRA Compliant Promissory Notes, Single Premium Life Insurance – no cash value, and an Irrevocable Funeral Expense Trust – funded by a Single Pay Whole Life Insurance Policy – guaranteed issue. Mr. Krause was recently certified to sell Partnership Long-Term Care Insurance products in the following states: California, Connecticut, Idaho, Indiana, New York, Pennsylvania, and Virginia. Finally, in order to help those clients who have an annuity that is not Medicaid Compliant (post DRA), Krause Financial Services has created an opportunity for those clients to sell their annuities on the secondary market.

Krause Financial Services looks forward to serving you, and your clients, regarding their Medicaid compatible product needs.

PREFACE

With my presentation for the Kansas Bar Association, Elder Law CLE, being limited to annuities, this outline will only focus on the use of a Medicaid Compliant Annuity (“MCA”) as a Medicaid planning tool.

With 21 months having passed since President Bush signed the Deficit Reduction Act of 2005 (“DRA”) into law, 33 states, including Kansas, have passed the required DRA legislation. The primary purpose of the DRA legislation was to curb federal spending. Within the DRA legislation, Congress modified existing Medicaid rules and statutes. As a result, elder law attorneys have had to change the way that they conduct their Medicaid planning practices, as some of the well known Medicaid planning techniques and strategies were either curtailed, modified, or eliminated by the DRA legislation.

1. 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 individual¹, the investment is considered a countable resource for Medicaid 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 Medicaid purposes.

¹ 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. The surrender charge will reduce the value of the annuity.

2. THE PARTIES TO A MEDICAID COMPLIANT ANNUITY

There are generally five parties to an MCA, including:

A. Issuer

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

B. Owner

The owner is the party who makes the investment into the MCA.

C. Annuitant

The annuitant is the party who is the measuring life in a tax deferred annuity. However, once a tax deferred annuity is converted to an MCA, or an MCA is purchased directly from the insurance company, the annuitant is no longer a necessary party in that the MCA has a specified term of payments.

D. Payee

The payee is the party who receives the payments from the MCA.

E. Beneficiary

Following the death of the owner, the beneficiary is the party who receives any residual payments from the MCA. MCA's 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.

Interesting Fact: In the majority of MCAs, the owner, annuitant, and payee are the same person.

3. FEDERAL HISTORY OF MEDICAID COMPLIANT ANNUITIES – PRE DRA

Medicaid Compliant Annuities were first addressed by the Omnibus Budget Reconciliation Act of 1993 (“OBRA”)². 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 Medicaid 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 Medicaid life expectancy. This test was referred to as the “actuarially sound test”. Additionally, in order to determine the appropriate Medicaid life expectancy table to be used, Transmittal 64 provided Male and Female Medicaid Life Expectancy Tables³. Since the implementation of OBRA and Transmittal 64, many states, including Kansas, have supplemented the federal rules and regulations with some of their own provisions.

² The OBRA legislation was passed in August of 2003.

³ See §3258.9(B) of Transmittal 64

4. DRA – ANNUITY REGULATIONS – FEDERAL VIEW

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

A. Remainder Beneficiary

The purchase of an 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 unless the spouse or “a representative of such child” dispose of their interest for less than fair market value in which case the State must be named in the first position⁴.

Note: On December 20, 2006, as a result of the “Tax Relief and Health Care Act of 2006” (“TRHC 06”) Congress, by way of a technical correction, 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 aforementioned technical correction was retroactive to the implementation of DRA.

B. Availability

An 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

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

retirement annuity or purchased with the proceeds from certain retirement assets, or (b) the annuity is irrevocable and nonassignable, is actuarially sound, and provides for equal payments with no deferral or balloon payments⁵.

C. Disclosure

Applicants must disclose any interest of the applicant or the community spouse in any annuity in any application or recertification of eligibility.

The State must notify the issuer of its position as a preferred beneficiary and may require the issuer to notify it when there is a change in amounts being withdrawn.

5. DRA – ANNUITY REGULATIONS – KANSAS VIEW

As a result of Revision Number 31 to the Kansas Economic and Employment Support Manual (“KEESM”), the Kansas Department of Social and Rehabilitation Services (“DSRS”) amended its annuity rules, to-wit:

1. If the LTC individual or spouse purchases or transfers assets into an annuity in which he or she retain ownership and the return is not commensurate with the individual’s life expectancy, an uncompensated transfer has occurred. For transfers into an annuity owned by another individual, the transfer is viewed as a gift for inadequate consideration. Specific treatment of the annuity is determined by the date the annuity was purchased. For transfer of property purposes, a purchase includes the initial acquisition of the annuity, as well as any substantial transactions. A substantial transaction is any action taken by the individual

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

that substantially changes the course of payment to be made by the annuity or the treatment of the income or principal of the annuity. These actions include additions of principal, elective withdrawals, requests to change the distribution of the annuity, elections to annuitize the contract and similar actions taken by the individual.

Use the later of the date the individual initially acquired the annuity or the date of the last substantial transaction to determine the date the annuity is purchased per the following (a) or (b).

- a. Annuities purchased before February 8, 2006 – The annuity is considered an uncompensated transfer if it is not actuarially sound. To be considered actuarially sound, the annuity must be:
 - i. Purchased from a life insurance company or other commercial company that sells annuities as part of its normal course of business;
 - ii. Provide substantially equal payments with no balloon, deferred or graduated payments, except for variations related to interest rate changes;
 - iii. Annuitized for the individual or spouse; and
 - iv. Be expected to return the full principal and interest within the annuitant's life expectancy.
- b. Annuities purchased on or after February 8, 2006 – The annuity is considered uncompensated unless Kansas Medicaid is named as the remainder beneficiary of the annuity for the total of medical assistance paid by Medicaid. If the LTC individual has a spouse, minor child or disabled child, Kansas Medicaid must be named as the next remainder

beneficiary after these individuals. Failure to name Kansas Medicaid as the remainder beneficiary in the correct position results in an uncompensated transfer.

6. DRA ANNUITY PLANNING – KANSAS

In light of Kansas' implementation of the DRA Regulations, the following annuity planning strategies are provided:

A. Individual Case

In the case of an individual/Medicaid applicant, the individual will have two MCA planning opportunities:

1. Short Life Expectancy

If the individual has a very short life expectancy, in light of his or her Medicaid life expectancy, an MCA, by itself, will provide the best economic result, to-wit:

Mrs. 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 \$5,000. The Medicaid rate for the nursing home is \$3,000. After purchasing a pre-paid funeral plan, some personal property, and setting aside \$2,000 in her checking account, Mrs. Smith has a spend-down amount of \$100,000. In order to gain immediate Medicaid eligibility, Mrs. Smith purchases an MCA with the \$100,000. The MCA is structured with 79 monthly payments of \$1,287.04. As a result of the MCA purchase, Mrs. Smith becomes immediately eligible for Kansas Medicaid benefits,

and her monthly Medicaid co-pay to the nursing home is \$2,762.04⁶. This amount was determined by totaling her monthly income from Social Security, pension, and her MCA, and reducing it by her \$60 monthly personal needs benefit.

Economic Result

If Mrs. Smith dies in month 12, with the Kansas Department of Social and Rehabilitation Services (“DSRS”) named as the primary beneficiary of her MCA, DSRS will be looking to collect \$2,855.52⁷ for Mrs. Smith’s Medicaid room and board costs. With Mrs. Smith’s MCA having 67 monthly payments remaining - \$86,231.68, less the \$2,855.52 owed to DSRS, Mrs. Smith’s children, as the secondary beneficiary of Mrs. Smith’s MCA, will receive \$83,376.16 in residual monthly payments. The stand-alone MCA Plan provided an excellent opportunity for Mrs. Smith to transfer wealth to her children.

2. Long Life Expectancy

If the individual has a longer life expectancy, in light of his or her Medicaid life expectancy, a Half-a-Loaf Plan will provide the best economic result, to-wit:

If Mrs. Smith is an Alzheimer’s resident, and is expected to live well beyond her 79 month Medicaid life expectancy, she

⁶ (SS/\$1,050 + Pension/\$485 + MCA/\$1,287.04) – Personal Needs Allowance/\$60 = \$2,762.04

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

would not want to proceed with a stand-alone MCA. The reason for this relates to the fact that if she lives for the entire duration of her stand-alone MCA, all of the monthly income from the MCA would have been contributed to the nursing home – no opportunity for a wealth transfer. With the Half-a-Loaf Plan, Mrs. Smith would immediately gift away \$52,800 of the \$100,000 spend-down amount. The immediate gift amount would create a 13.2 month divestment penalty period⁸. As for the remaining spend-down amount of \$47,200, it would be immediately invested in a 14 Month MCA⁹, which would pay Mrs. Smith \$3,381.98 per month. Following the gift, and the purchase of the MCA, Mrs. Smith would immediately apply for Kansas Medicaid benefits. With Mrs. Smith being “otherwise eligible”, except for the divestment penalty period, she would be entitled to go on economic Medicaid benefits following the final monthly payment from her 14 Month MCA.

Economic Result

With the Half-a-Loaf Plan, Mrs. Smith’s children will retain the gift amount of \$52,800. This is an excellent result in light of the fact that had Mrs. Smith not conducted any Medicaid

⁸ When \$52,800 gift amount is divided by Kansas’ Monthly Divestment Penalty Divisor of \$4,000, the result equals a 13.2 month divestment penalty period.

⁹ With MCA’s being issued in whole months, it is not possible to issue an MCA with a period certain of 13.2 months. Instead, a 14 Month MCA will be issued.

planning she would have exhausted her \$100,000 spend-down amount in 28.8 months¹⁰.

B. Community Spouse Case

In the case of a community spouse, the community spouse will purchase an MCA structured over his/her Medicaid life expectancy. However, with the concern that DSRS must be named as the primary beneficiary of the MCA, a community spouse is likely to shorten the period certain associated with the MCA in order to avoid the potential pay back to DSRS.

7. CONCLUSION

Despite the enactment of the DRA, Medicaid Compliant Annuities will still provide a reasonable Medicaid planning opportunity for those individuals looking to qualify for Medicaid benefits.

¹⁰ This amount was determined by reducing the \$5,000 monthly nursing home cost by Mrs. Smith's monthly Social Security and pension income of \$1,535 and dividing the net result into the \$100,000 spend down amount.