

THE USE OF ANNUITIES IN MEDICAID PLANNING: THE PAST, PRESENT, AND FUTURE

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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 CEO 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, and is 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.

Finally, in that long-term care insurance is now highly recommended to protect against future long-term care costs, in May of 2008, Mr. Krause obtained the designation of Long-Term Care Professional (LTCP) from the Center for Insurance Education and Professional Development.

PREFACE

With this presentation being made to the Wisconsin NAELA Chapter on the topic of The Use of Annuities in Medicaid Planning: The Past, Present, and Future, and with time being limited, 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 effected by current and future changes in MA law. For those reasons, the accuracy and completeness of such information, and the opinion of Mr. Krause, is 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 MA Compliant Annuity strategies outlined in these materials may not be suitable for everyone.

INTRODUCTION

With more than two years having passed since President Bush signed the Deficit Reduction Act of 2005 (“DRA”) into law, which legislation was designed to curb federal spending, 8 states¹, including Wisconsin, have not yet implemented the DRA changes. Within the DRA legislation, Congress modified Medicaid rules and statutes, including those related to annuities. As a result, in those states where DRA is now in full swing, elder law attorneys have had to change the way that they utilize annuities.

HISTORY OF ANNUITIES

How long have annuities been around? Annuities have been around forever. One of the first annuities was traced back to the 18th century, where an annuity was offered to a minister and his family. Today, annuities are everywhere, and most clients will have one, or more. With a garden variety of annuities now available, clients will need to focus on their specific needs and goals in order to determine which product will serve them the best.

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, which is also known as a “commercial annuity.” When an insurance company is not involved, the annuity is considered a “private annuity.” 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 individual², the investment is considered a countable resource for MA purposes. On the other hand, an immediate annuity is generally not considered a countable resource, because the individual does not have the

¹ The 8 states include: California, Hawaii, Illinois, Indiana, New Mexico, Oklahoma, West Virginia, Wisconsin, and Wyoming.

² 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.

ability to access the investment value. Similar to a pension, the individual will only have access to the monthly payments. Therefore, 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, but not vice versa.

THE PARTIES TO AN ANNUITY

The five parties to an annuity include:

1. Issuer/Obligor

The issuer is generally an insurance company, and is the party that promises to make the payments scheduled within the annuity.

2. Owner

The owner is the party who controls the 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 immediate annuity, or an immediate annuity is purchased directly from the insurance company, the annuitant is no longer a necessary party in that the annuity has a specified term of payments.

4. Payee

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

5. Beneficiary

Following the death of the owner, the beneficiary is the party who receives any residual payments from the annuity. 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”)³. 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 included gender based life expectancy tables⁴. Since the implementation of OBRA and Transmittal 64, many states, including Wisconsin, have supplemented the federal rules with their own regulations.

WISCONSIN HISTORY OF MA ANNUITIES – PRE DRA

On April 30, 2008, the Wisconsin Medicaid Eligibility Handbook (“MEH”) was updated by way of Release 08-02. 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”. Please find a complete copy of the aforementioned sections in the pocket part of The Krause Report-2008.

Practical Point: In order to meet the regulations outlined in Release 08-02, a MA annuity must be structured with equal payments that are scheduled within the owner/annuitant/payee’s MA lifetime. The MA annuity contract must also contain

³ The OBRA legislation was passed in August of 2003.

⁴ See §3258.9(B) of Transmittal 64.

language which makes it irrevocable, and non-assignable. Finally, in support of its non-marketability, 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...⁵.

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”, and in its place inserted the words “institutionalized individual”. Additionally, TRHC 06’ stated that the 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 payments⁶.

3. Disclosure

At the time of an MA application, or MA recertification, the MA applicant, and his or her spouse, 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

⁵ See DRA §6012(b); 42 U.S.C. §1396p(c)(1)(F)

⁶ See DRA §6012 (c); 42 U.S.C. §1369p(c)(1)(G)

may require the issuer to notify it when there is a change in amounts being withdrawn from the MA annuity.

MA ANNUITY PLANNING FOR A MARRIED COUPLE – POST DRA

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

PowerPoint Slides: *The following example is illustrated in PowerPoint slides 15 through 21.*

Case Facts: David and Bonnie Jones are both age 85. After a long struggle with Parkinson's disease, David entered a nursing home in June 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. David has monthly income from social security and pension of \$1,200.00, while Bonnie only social security of \$500.00. The nursing home bill is expected to average \$6,000.00 per month. In light of this fact, Bonnie would like to immediately qualify David for MA benefits.

MA Annuity Plan: With David and Bonnie having total countable resources of \$200,000.00, and a spend-down amount of \$98,000.00, Bonnie will need to purchase a MA annuity with the spend-down amount. With Bonnie being 85 years of age, and having a MA life expectancy of 106 months (DOB 5/12/1923), the MA annuity will pay her \$966.15 per month. If Bonnie purchases the MA annuity in June of 2008, which immediately eliminates the spend-down amount, David will become immediately eligible for MA benefits. As a result, in June of 2008, David's MA co-pay is \$0.00. Additionally, in July of 2008, and each month thereafter, David's MA co-pay will be \$339.48.

Economic Results: With David and Bonnie expecting to pay \$6,000.00 per month for David's nursing home care, by qualifying for MA benefits in June of 2008, and having a MA co-pay of \$0.00, Bonnie and David will

experience a total savings in that month. In July of 2008, and each month thereafter, when David's MA co-pay increases to \$339.48, Bonnie and David will experience a \$5,660.52 savings on David's monthly nursing home care costs.

Advantage of MA Annuity Plan: David obtains immediate MA eligibility.

Disadvantages of MA Annuity Plan: If Bonnie enters a nursing home within the 106 month period certain term of her MA annuity, and qualifies for MA benefits, she will lose all future monthly payments from her MA annuity to the nursing home. If Bonnie pre-deceases the 106 month period certain term of her MA annuity, with the MA program being the primary beneficiary of her MA annuity to the extent of MA benefits provided to David, her MA annuity may leave little, or no, residual benefits to her intended beneficiaries – the Jones children.

MA ANNUITY PLANNING FOR AN INDIVIDUAL – POST DRA

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: Carol Nelson, 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, Carol has a spend-down amount of \$134,900.00.

MA Annuity Plan: In order to gain immediate MA eligibility, Carol purchases a MA annuity with the \$134,900.00. The MA annuity is structured with 106 monthly payments of \$1,318.05. As a result of the MA annuity purchase, Carol becomes immediately eligible for MA benefits, and her monthly MA co-pay to the nursing home is \$2,808.05⁷. 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 Carol 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 \$16,703.40⁸ for Carol’s MA room and board costs. With Carol’s MA annuity having 94 monthly payments remaining - \$125,214.75, less the \$16,703.40 owed to DHFS, Carol’s children, as the secondary beneficiaries 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 Carol, in that she immediately qualified for MA benefits, and she was able to provide a wealth transfer to her children.

Long Life Expectancy Case: If the individual has a long 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 24 through 28.*

⁷ (SS/\$1,050.00 + Pension/\$485.00 + MA annuity/\$1,318.05) – Personal Needs Allowance/\$45.00 = \$2,808.05.

⁸ 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.

Case Facts: Joan Brothers, a widow, is 85 years of age. After a long struggle with Alzheimer's disease, Joan entered a nursing home in June of 2008. Joan has limited furniture and personal property, and \$136,900.00 in savings accounts. Joan 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. Joan would like to qualify for MA benefits as soon as possible, and provide a wealth transfer to her children.

MA Annuity Plan: With the Gifting/Short-Term MA Annuity Plan, Joan 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 period⁹. As for the remaining spend-down amount of \$63,033.92, it would be immediately invested in a 13 Month MA annuity¹⁰, which would pay Joan \$4,876.97 per month. Following the gift, and the purchase of the MA annuity, Joan would immediately apply for Wisconsin MA benefits. With Joan being "otherwise eligible", except for the divestment penalty period, she would be entitled to go on LTC MA benefits following the 12.87 month divestment penalty period.

Economic Result Advantages: With the Gifting/Short-Term MA Annuity Plan Plan, Joan's children will retain the gift amount of \$71,866.08. This is an excellent result in light of the fact that had Joan not done any MA planning, she would have exhausted her \$134,900.00 spend-down amount in 27.53 months¹¹.

Disadvantage: Joan has to live longer than the 12.87 month divestment penalty period in order to achieve a nursing home cost savings.

⁹ 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.

¹⁰ 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.

¹¹ 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.

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.

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 person’s name.

CONCLUSIONS

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. Finally, with DRA changes on the verge of being implemented in Wisconsin, it is my opinion that the safest course of action for elder law attorneys at this time is to develop MA annuity plans based on the DRA changes.