

# The Use of Annuities in Medi-Cal Planning: A Likely Post DRA Approach

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# Deficit Reduction Act of 2005

- Signed into law on February 8, 2006
- Six states have not yet implemented DRA
  - California, Hawaii, Illinois, New Mexico, West Virginia, Wyoming
- DRA has impacted the way that annuities are structured
  - The new trends: Shorter terms and reduced wealth transfers to children



# History of Annuities

- Been around since the 18<sup>th</sup> century
- First used for retirement planning
- Became popular as a Medicaid/Medi-Cal tool in the early 90's
- There are more than 1,400 life insurance companies, but less than 10 that offer Medicaid/Medi-Cal Compliant Annuities



# Two Basic Types of Annuities

- Tax-Deferred Annuity
  - Not a Medicaid/Medi-Cal planning tool
  - Pile of cash
  - Can be converted to an Immediate Annuity
- Immediate Annuity
  - Medicaid/Medi-Cal planning tool
  - Future stream of income – monthly payments
  - Cannot be converted to a Tax-Deferred Annuity



# Taxation of Annuities

- Tax-Deferred Annuity
  - Deferral of taxes on appreciation
  - Taxes will be paid upon liquidation
- Immediate Annuity
  - Each payment is comprised of principal and income
  - Taxes will be paid annually – income portion only



# Annuities – Countable Resource?

- Tax-Deferred Annuity
  - Generally “yes”
- Immediate Annuity
  - Generally “no”



# Parties to an Annuity

- Issuer/Obligor – Insurance Company
- Owner – Controls contract
- Annuitant – Measuring life
- Payee – Receives payments
- Beneficiary – After death of owner, receives payments – primary - secondary

Practical Point: Owner/Annuitant/Payee



# Federal History – Pre DRA

- Annuities first addressed by Omnibus Budget Reconciliation Act of 1993 (“OBRA”)
- Healthcare Financing Administration Transmittal 64 – November of 1994
  - Actuarially sound test
  - Age/Gender life expectancy table



# California History – Pre DRA

- Prior to August 11, 1993
  - Immediate annuities only
- August 11, 1993 to March 1, 1996
  - Immediate annuities + actuarially sound test + hardship available
- After March 1, 1996
  - Hardship eliminated
- On or After September 1, 2004
  - Added estate recovery



# Federal History – Post DRA

- Classification
  - Asset unless: 1) retirement annuity, or 2) irrevocable, non-assignable, actuarially sound, and equal payments
- Disclosure
  - At application and recertification: annuities must be disclosed, including any changes
- Remainder Beneficiary Designation
  - State remainder beneficiary, unless spouse, minor or disabled child



# Medi-Cal Annuities-Senate Bill 483

- Imposes the same requirements as Federal DRA legislation
- Exempts community spouse annuities consisting of CSRA amount
- To be applied prospectively – protects past planning and Medi-Cal eligibility



# Post DRA Medi-Cal Planning-Couple

- George entered nursing home on 2/1/09
- Betty – home, car, furniture, pre-paid funeral, and \$109,560.00
- Spend-down amount: \$88,440.00
- Betty purchases a Medi-Cal Compliant Annuity – 79 months: \$1,244.35
- Result: Immediate Medi-Cal eligibility, co-pay February 2009: \$0.00, March 2009: \$170.35



# Co-Pay Calculation February 2009

• MMNA	\$2,739.00
• Less Betty's SS income	\$ 500.00
• Shortfall	\$2,239.00
• Less George's income	\$1,200.00
• Co-pay	\$ 0.00



# Co-Pay Calculation March 2009

• MMNA	\$2,739.00
• Less Betty's SS income	\$ 500.00
• Less Betty's annuity income	\$1,244.35
• Shortfall	\$ 994.65
• George's income	\$1,200.00
• George's excess Income	\$ 205.35
• Less personal needs	\$ 35.00
• Co-pay	\$ 170.35



# Economic Results

- Advantage
  - Immediate Medi-Cal eligibility
  - Reduced co-pay from \$6,000.00 per month to \$0.00, and \$170.35
- Disadvantage
  - If Betty pre-deceases the 79 month term, State obtains recovery
- No Planning
  - Without any planning, the \$88,440.00 would have lasted only 14 months



# Potential Recoveries

Medi-Cal Rate: \$4,200.00; Co-Pay: \$170.35;  
Annuity Total Pay out: \$98,303.65

<b>Month</b>	<b>Claim</b>	<b>State</b>	<b>Children</b>
12	\$48,355	\$48,355	\$35,015
24	\$97,711	\$68,439	\$0
36	\$145,067	\$53,507	\$0
48	\$193,423	\$38,574	\$0
60	\$241,779	\$23,642	\$0



# Re-Insure Annuity

- If a community spouse wants to avoid a potential recovery in the event of an untimely death, they may want to purchase a life insurance policy to re-insure the annuity payout
- In Betty's case, a \$70,000.00 term life insurance policy would be sufficient
- Can we insure the community spouse – age, health?



# Alternative Annuity Plan

- Reduce the 79 month term to 24 months
  - Increases Medi-Cal Compliant Annuity monthly payment from \$1,244.35 to \$3,733.94
    - Eliminates the income shift from George to Betty – MMNA is \$2,739.00
    - Betty's income increases from \$1,744.35 to \$4,233.94
    - George's co-pay increases from \$170.35 to \$1,165.00, and the amount will continue through the 24th month



# Post DRA Medi-Cal Planning Individual - Short Life Expectancy

- Carol, age 85, entered a nursing home on 2/1/09, is doing poorly, not expected to live more than 12 months
- Carol has no major assets, pre-paid funeral, and a spend-down amount of \$134,900.00
- Carol purchases a Medi-Cal Compliant Annuity – 79 months: \$1,898.04 - beginning March of 2009
- Medi-Cal rate is \$4,200.00; private pay rate is \$6,000.00
- Result: Immediate Medi-Cal eligibility



# Co-Pay Calculation February 2009



# Co-Pay Calculation March 2009



# Primary Beneficiary Pay Back

- If Carol dies in month 12, Medi-Cal would be looking to collect approximately \$15,443.52
- \$4,200.00 (Medi-Cal rate) less \$2,913.04 (co-pay) x 12 months



# Benefit to Children

- Carol's children will receive \$111,725.16

Total annuity payout:	\$149,945.16
Less 12 payments made:	\$ 22,776.48
Less payment to State:	\$ 15,443.52

**Note:** Medi-Cal Compliant Annuities do not normally make a payment in the same month as the Contract. With the first payment in the following month – aforementioned amounts would be adjusted.



# Post DRA Medi-Cal Planning Individual - Long Life Expectancy

- Mary, age 85, entered the nursing home on 2/1/09
- Mary has no major assets, pre-paid funeral, and a spend-down amount of \$134,500.00
- Nursing home bill expected to average \$6,000.00
- Monthly SS income of \$1,100.00
- Mary's children believe she will live more than 79 months
- Mary gifts \$71,105.42 to her children – 12.93 month penalty period created
- Mary purchases a Medi-Cal Compliant Annuity – 13 months: \$4,894.06



# How was the \$71,105.42 Gift Amount Determined?

- Nursing home cost/\$6,000.00 less monthly income/\$1,100.00 = \$4,900.00
- \$4,900.00 + monthly divestment penalty divisor/\$5,946.00 = \$10,396.00
- Spend-down amount/\$134,500.00 divided by \$10,396.00 = 12.93
- 12.93 times divisor/\$5,496.00 = \$71,105.42



# Economic Results

- Assuming the Medi-Cal Compliant Annuity makes its first payment with the contract, Mary will have \$5,994.06 of monthly income in which to pay the \$6,000.00 nursing home bill
- On month 14, Mary is economically eligible for Medi-Cal benefits, her monthly co-pay would be \$1,065.00 (SS less \$35.00)



# Important Annuity Fact

- With a 12.93 divestment penalty period, the case is suited for a 13 month Medi-Cal Compliant Annuity
- Medi-Cal Compliant Annuities can only be sold in whole months – 12 months or 13 months, not 12.93



# Important Steps

- In order for the Gifting/Short-Term Medi-Cal Compliant Annuity Plan to be successful, the following must occur at the same time:
  - In nursing home
  - Make the gift
  - Purchase the annuity
  - Apply for Medi-Cal benefits
- equal's "Otherwise eligible," but for the transfer penalty



# Converting an IRA Account into a Medi-Cal Compliant Annuity

- An existing IRA account can be converted to an IRA Medi-Cal Compliant Annuity by way of a “plan administrator to plan administrator transfer” or “60 day rollover.”
- The 60 day rollover method is preferred - timing
- This Medi-Cal strategy only applies to individuals, not a community spouse



# 5 Points of Discussion – Point 1

1. According to 42 USC §1396p(c), it appears that if an annuity is irrevocable, non-assignable, actuarially sound, and has equal payments, it does not require the State Medicaid Program to be the primary beneficiary.

Practical Point: The majority of the DRA states have elected to require both (F) – remainder beneficiary and (G) – 4 factors.



# 5 Points of Discussion – Point 2

2. In a husband and wife case, if the CS reduces the term of the annuity – no shifting of income, when the annuity ends, does the CS get to receive income from the institutionalized spouse? Assume CS has \$500.00 of SS income. Does it matter what the CS's CSRA amount is at the time?



# 5 Points of Discussion – Point 3

3. Three states have redefined the term actuarially sound – North Dakota, Oregon, and Washington.

Does the new definition eliminate Gifting/Short-Term Medicaid Compliant Annuity Plans?

Note: The three states do not allow for partial cures.



# 5 Points of Discussion – Point 4

4. Is a Reverse Half-a-Loaf Plan better than a Gifting/Short-Term Medicaid Compliant Annuity Plan?  
Why?



# 5 Points of Discussion – Point 5

5. With a five year look-back period, a pooling of gifts, and a delayed start of the divestment penalty period, how does long-term care insurance (partnership and non-partnership) help families?



# Conclusion

- For 2009, and beyond, Medi-Cal Planning will provide a significant opportunity to those planners who stay abreast of Medi-Cal changes.



# For More Information

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