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The Deficit Reduction Act of 2005: a sea change in Medicaid planning

By Geoff Bernhardt, Attorney at Law

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 (DRA 2005), which includes the most significant changes in Medicaid law since the Omnibus Budget Reconciliation Act of 1993. Described below are the changes DRA 2005 makes to 42 USC § 1396p and 42 USC § 1396r-5.

Start of Medicaid penalty period is delayed

For the elder law attorney, the most significant change in DRA 2005 is the change in the start of the ineligibility period triggered upon a transfer of assets for less than fair market value. Prior to DRA 2005, if an applicant transferred assets for less than fair market value, he or she was ineligible for Medicaid assistance for a period of time, based on the amount transferred. Transfers by a married Medicaid applicant's spouse or agent have the same effect. The period of ineligibility or "penalty period" is determined by dividing the amount of the uncompensated transfer by the monthly average cost of long term care as determined by state administrative rule. The monthly average cost of care is called the "divisor." In Oregon, the current divisor is $4,700. Under this calculation, a $47,000 gift created a ten-month period of ineligibility for Medicaid assistance.

Pre-DRA 2005, the Medicaid penalty period started on the first day of the month in which the asset was transferred. This gave rise to the "transfer-and-wait" or "half-a-loaf" strategy. Under this strategy, an applicant with $100,000 could transfer $50,000 out of his or her name, and retain the remaining $50,000 to pay for care during the penalty period. At the expiration of the penalty period, the applicant could be eligible for Medicaid long term care assistance, so long as assets in the applicant's name were within Medicaid qualifying limits.

DRA 2005 shifts the start of the penalty period from the first day of the month of the transfer to the later of that date or the date on which the individual is eligible for medical assistance under the state plan and would otherwise be receiving institutional level care based on an approved application for such care but for the application of the penalty period.

There are two significant components of this rule. First, the period of ineligibility does not begin until the individual has moved into "institutional level care," which is defined in the statute to include nursing home and waivered home or community-

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based services. Second, the period of ineligibility does not begin until the applicant would be eligible for Medicaid assistance, meaning until a person has spent down to $2,000.

Example: (Pre-DRA 2005 Transfer): A Medicaid applicant transfers $112,800 to a child on January 1, 2006. She keeps $100,000 in her name. She goes into care April 1, 2006, and begins spending down her remaining $100,000. Since Oregon's monthly average cost of long term care is $4,700, under pre-DRA 2005 law, this applicant would be ineligible for Medicaid assistance for 24 months, beginning on the date of the transfer. On January 1, 2008, the Medicaid penalty period ends and is no longer a factor in determining her eligibility for benefits.

Example: (Post-DRA 2005 Transfer): A Medicaid applicant transfers $112,800 to a child on March 1, 2006 (post-DRA 2005). She goes into care shortly after that, and by January 1, 2008, she has spent her savings down to $2,000. The 24-month penalty period resulting from the $112,800 transfer does not even begin until January 1, 2008, meaning the applicant will not be eligible for assistance until January 1, 2010.

Look-back period increased from 36 to 60 months

States are required to determine if a Medicaid applicant has transferred assets for less than fair market value. Prior to DRA 2005, states had to determine if a Medicaid applicant transferred assets to an individual in the 36 months immediately preceding the date of the Medicaid application. In the case of a transfer to or from a trust, the "look-back" period was extended to 60 months. DRA 2005 extends the look-back period for all transfers to 60 months. Medicaid applications may become more burdensome, since applicants may have to provide financial documents going back 5 years. In addition, applicants may find themselves being penalized for transfers made years before long term care costs became a concern, such as holiday or graduation gifts, or charitable and religious contributions.

No "rounding down" of transfer penalty periods

Pre-DRA 2005, states could "round" penalty periods to the nearest whole month. For example, in Oregon, a $49,000 transfer, divided by the $4,700 divisor, creates a 10.42 month period of ineligibility. Pre-DRA 2005 rules allow Oregon to round the penalty period down to an even ten months. DRA 2005 forbids the practice. Under DRA 2005, the applicant making a $49,000 transfer would create a ten-month, twelve-day period of ineligibility. The Oregon Medicaid program is likely to have some difficulty adjusting to this change, because Medicaid payments to HMOs and other capitated care systems are made on a monthly basis.

Effective date of new transfer rules

The transfer rules apply to all transfers of assets made on or after February 8, 2006. However, states have a grace period to enact new legislation needed to bring their Medicaid rules into compliance with DRA 2005. Hence, there may be a short window of time in which transfers of assets after February 8, 2006, will be considered using pre-DRA 2005 state law and administrative rules. At this point, we do not know whether Oregon will treat all transfers made after February 8, but before the effective date of the proposed Oregon administrative rules (projected to be July 1, 2006) under the old rules, or whether the state will use the new rules to analyze those transfers if the Medicaid application is made on or after July 1, 2006.

Hardship waivers

What options are available to an elder who has created a period of ineligibility, yet lacks the resources to pay for his or her care? One possibility is to seek a hardship waiver. DRA 2005 requires each state to have a process for seeking a hardship waiver when a period of ineligibility would deprive the individual of medical care that would endanger the individual's life or health, or would deprive the individual of food, clothing, shelter, or other necessities of life. States have the option of paying for care for up to 30 days while the application for a hardship waiver is being considered. Since a care facility may not transfer an applicant for nonpayment unless alternative care exists, a care facility may apply for a hardship waiver of the transfer penalty on behalf of a resident if the resident consents.

Annuities: state must generally be the first remainder beneficiary

Pre-DRA 2005, many states allowed an applicant to reduce the value of his or her countable assets by purchasing an annuity, thereby changing an asset into a stream of income. Prior rules required that the annuity be irrevocable and nonassignable. The annuity also had to "actuarially sound," meaning the annuity had to provide for payment of all income and principal to the annuitant within the annuitant's actuarial life expectancy. Annuities that did not comply with these requirements were treated as a transfer of resources for less than fair-

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market value, resulting in a period of ineligibility for Medicaid.

DRA 2005 still permits this practice, but imposes some additional conditions. First, the state must be named as the first remainder beneficiary for at least the total amount of Medicaid assistance paid on behalf of the annuitant, unless the annuitant has a spouse living in the community, a minor child, or a disabled child. In that case, the spouse, minor child, or disabled child may be named as the first remainder beneficiary, and the state must be named as the second remainder beneficiary.

Second, the annuity must provide for payments in equal amounts during the term of the annuity, with no deferred or balloon payments.

Rules similar to the DRA 2005 annuity provisions are found at OAR 461-145-0020, which took effect on January 1, 2006.

Income-first rule is mandated for all states

Under the "income-first" rule, the community spouse may not retain resources in excess of the community spouse resource allowance to generate additional income for his or her monthly maintenance needs allowance until all available income of the ill spouse has first been transferred to him or her. Pre-DRA 2005 rules allowed the states to decide for themselves whether to follow the income-first rule, or to instead allow assets in excess of the community spouse resource allowance be transferred to the community spouse to generate income to meet the monthly maintenance needs allowance. Oregon administrative rules required the income-first rule to be followed even before DRA 2005; now it is mandatory for all states.

Substantial home equity may disqualify an applicant

Pre-DRA 2005, the equity in an applicant's home was an exempt resource, so long as the applicant resided in the home or intended to return home after receiving care, or the applicant's spouse, minor child, blind child, or disabled child resided in the home. DRA 2005 provides that an applicant with home equity in excess of $500,000 will not be eligible for assistance even if the home would otherwise be exempt. States have the option to increase this threshold to $750,000.

Entrance fees to continuing care retirement communities may be treated as available resources

DRA 2005 provides that entrance fees to continuing care retirement communities shall be considered an available resource if the individual has the ability to use the entrance fee to pay for care, or is eligible for a refund upon the individual's death or termination of the continuing care retirement community contract.

Constitutionality of DRA 2005

DRA 2005, as signed by President Bush, contains a flaw that may make it unconstitutional. Due to a clerical error, the version of the law that passed the House of Representatives had a different time period for reimbursing medical providers for some medical equipment than the version that passed the Senate. Democrats in the House and Senate unanimously opposed DRA 2005, and this clerical error could require another vote on the measure. In addition, elder law attorney Jim Zeigler has filed an action in the US District Court for the Southern District of Alabama for a declaratory judgment holding DRA 2005 unconstitutional.

Conclusion

DRA 2005 represents the most significant change in Medicaid planning since 1993. Strategies detailed in CLE materials published over the last 12 years are affected; these materials should not be relied upon unless read in conjunction with DRA 2005. Elder law attorneys should carefully study the provisions of DRA 2005 before advising clients on Medicaid and long term care issues. In particular, elder law attorneys should familiarize themselves with the new rules regarding transfers of assets, as reliance upon the old rules may result in clients being ineligible for needed Medicaid assistance for long periods of time, without assets available to pay for care. ■

Geoff Bernhardt is a Portland attorney.He serves on the board of directors of the Oregon Gerontological Association, the program committee of the Oregon Chapter of the National Multiple Sclerosis Society, and the Executive Committee of the Elder Law Section.