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MEDICAID: Protect Your Assets

By David A. Cutner

This article is the third in a series of articles about Elder Law

In last month's article on "Medicare & Medicaid: What's the difference," we looked at the scope and eligibility requirements of these two important government programs that provide benefits to seniors and disabled persons who have medical or health problems.

Very briefly, Medicare is insurance for acute medical needs, covering doctors, hospitals, nurses, and rehabilitation. Almost everyone over age 65 is eligible for Medicare, and most people pay modest premiums for this coverage.

Medicaid, on the other hand, addresses the needs of individuals who need long-term care (at home or in a nursing home), and who lack the means to pay for these services. Medicaid is also the "payer of last resort" of the medical expenses incurred by individuals in this program.

Today, people are living longer, but unfortunately many require help with the "activities of daily living" (bathing, dressing, cooking, eating, etc.). Many people who need long-term care prefer to remain at home, rather than going into a nursing home. However, obtaining home care can be "ruinously expensive."

Mary's Case

Let's examine this problem and some solutions -- in the context of a hypothetical case:

Mary Rogers lives at home in Brooklyn in the house that she and her deceased husband, George, purchased in 1965 for \$32,000. The house is now worth \$550,000. Mary and George managed to save about \$300,000 while both were working, and the money is now invested mainly in mutual funds. Mary is able to pay her expenses out of her Social Security and her teacher's pension, which total \$2,745 per month. However, there is little margin for unanticipated or extraordinary expenses. Since Mary is on a fixed income, she is concerned that rising taxes and the increased costs of living will eventually force her to spend money from her savings.

Mary's son, Walter, and her daughter, Ellen, take turns visiting Mary at least once a week. Each of them notices that Mary seems to be more forgetful than usual, and the house is not as clean and orderly as it used to be. Mary complains that her arthritis is bothering her, and she seems to have more difficulty walking and performing simple physical tasks.

One day, a neighbor calls Walter and tells him that she found Mary sitting on a park bench about two blocks from her house. Mary seemed confused and said that she could not find her way home.

Walter then calls Ellen and the two of them discuss Mary's condition. They agree that it would be best if Mary had an aide at the house for at least 8 to 12 hours a day, to help her and assure her safety. Neither Walter nor Ellen has any idea what this will cost, and they are surprised to find out that it will be quite expensive, at least \$150 per day, or approximately \$4,500 per month. They are aware that Mary has no room in her budget for this kind of expense, and that she will have to start spending her savings in order to pay for care.

Walter and Ellen grow increasingly concerned when they think about Mary's long term prospects. Mary is only 72 years of age, and is expected to live at least another 15 years. Certainly, her needs for care, and her medical expenses will grow, but her resources will be rapidly depleted by these expenses. Walter and Ellen each have children in high school and college, and are in no position to pay any significant portion of Mary's expenses.

In frustration, Walter and Ellen make an appointment with an Elder Law attorney to discuss Mary's situation, to see whether there is any way Medicaid would provide a home care attendant for Mary. However, they have little hope of accomplishing much, because they have heard about the Medicaid "look back" and penalty periods.

The Elder Law attorney's advice

After telling the Elder Law attorney about Mary's condition and her finances, the attorney informs them that, in order to be eligible for Medicaid home care benefits in 2008, Mary could have no more than \$4,350 in resources (assets), and no more than \$745 per month in income. Walter and Ellen are starting to feel that they are wasting their time and money, but then the attorney informs them that Mary could nevertheless become eligible for Medicaid home care within a very short period of time. Here is the plan that the attorney proposed:

Mary's Home

Mary's house, even though it is now worth \$550,000, is not an obstacle to her obtaining Medicaid home care benefits. Walter had heard that the home is an exempt asset, and was pleased to hear that this information was correct. However, his relief quickly turned to disappointment when the attorney advised him that, upon Mary's death, Medicaid would assert a lien against the home and demand to be reimbursed for the cost of care provided to Mary during her lifetime.

However, the attorney advised that the home could be transferred to a protective trust, which would protect the home from the claims of all creditors, including Medicaid. This is because Mary would no longer be the owner of the home. However she would have the absolute right to live in the home for the rest of her life, as she would reserve a "life estate" and transfer only the remainder interest to the trust. Upon Mary's death, the life estate would be extinguished, and the home would go to the beneficiaries named in the trust, Walter and Ellen. Mary had always intended to leave the house to Walter and Ellen, and had already named them as beneficiaries under her will. By transferring the property under a trust instead of under a will, Mary could achieve the same result, without the cost and inconvenience of making the house subject to probate.

Ellen wondered out loud whether it would be simpler just to transfer the home to her and Walter right away, and avoid the cost of establishing the trust. The attorney then pointed out that, such a transfer would result in Walter and Ellen receiving a "carry over" tax basis in the home. As a result, if they sold the home at a later date, they would realize a taxable capital gain of the difference between the fair market value (currently \$550,000) and Mary's tax basis (\$32,000). Under current tax laws, Walter and Ellen would have to pay a significant tax.

However, if Walter and Ellen receive the house as beneficiaries of Mary's trust, then they would have the valuable benefit of a "stepped up" tax basis. In other words, Walter and Ellen would receive as their tax basis the fair market value of the house as of the date of Mary's death. If they sold the house right away, they would pay no capital gains tax. If they held onto the house for a period of time, then the capital gain would be measured by the difference between the sale price of the house and the "stepped up" tax basis, not Mary's original (\$32,000) basis in the house.

Ellen was starting to feel pleased that she and Walter had consulted the Elder Law attorney, but still had a nagging question in her mind about the Medicaid "look back" and penalty periods. The attorney addressed this concern also. He explained that the look back and penalty periods applied only in cases where a Medicaid applicant is seeking to obtain nursing home care. Since Mary desired home care, the transfer of her home to a trust would not impact her Medicaid application.

However, the attorney emphasized that, if Mary applied for nursing home care within the next five (5) years, then any transfers of Mary's money or property would result in a penalty period during which Mary would not be eligible for nursing home care paid by Medicaid. The attorney mentioned that different strategies could be employed to preserve assets if nursing care were needed, but suggested that they continue their discussion of obtaining home care for Mary.

Mary's Liquid Investments

The Elder Law attorney then turned his attention to Mary's liquid assets (approximately \$300,000), and advised that they would have to be transferred to another person in order to bring Mary within the Medicaid eligibility requirement of having no more than \$4,350 in resources.

The attorney advised that Mary's money could be transferred directly to Walter and Ellen, but that the money

would be safer in a trust. Both Walter and Ellen protested, and said that they would use the money only for Mary's benefit until she died. The attorney said that he did not doubt their honesty and good faith. However, he pointed out that they would become the legal owners of Mary's money, which would then be subject to claims of their potential creditors, their heirs if they predeceased Mary, or their spouses in a divorce proceeding. He also noted that either could get involved in an automobile accident, and be sued for a lot of money by someone injured in the crash.

The attorney suggested that Mary's money would be safer in a trust, where the money could not be accessed by creditors, heirs, or spouses. Careful consideration would have to be given to setting up the trust, and to Mary's investments, so that she would have always have enough, but not too much, income.

In any case, if transferred to her children or to a trust, Mary's money would not be subject to a "look back" period, and would not prevent Mary from obtaining Medicaid home care benefits.

Mary's Income

The Elder Law attorney explained that, under Medicaid's eligibility rules, Mary could not have more than \$745 per month in income. Since her income is \$2,745, Mary has \$2,000 in "excess income," sometimes referred to as a "spend down." This means that, generally, a Medicaid applicant must "spend down" her "excess income" by contributing it to her Medicaid provider. Walter immediately objected that Mary needed her income in order to pay her taxes, utilities, food costs, other living expenses.

The attorney then advised that a solution is available the "pooled income trust." This is a different type of trust than a trust that might be created to hold real estate or financial assets. The pooled income trust can be set up in New York by or for disabled persons with one of the charities that administers these trusts. The attorney explained how it would work: each month Mary would send her excess income to her pooled income trust, with instructions as to how to spend the money. After deducting a small administration fee, the pooled income trust would pay Mary's bills up to the amount available in her account.

The pooled income trust has a couple of significant features that must be borne in mind. First, Mary's money in the pooled income trust can be used only for her benefit. Mary cannot make a gift from the pooled income trust, or pay anyone else's expenses. However, she will keep \$745 out of her monthly income, and she can use this money for any purpose she pleases.

Another significant feature is that the charity is the beneficiary of the pooled income trust, and the creator of the trust cannot name her own beneficiaries. Accordingly, any of Mary's money that remains in the pooled income trust when she dies will go to the charity.

Nevertheless, the pooled income trust is frequently an extremely effective strategy for preserving the income of applicants for Medicaid home care, many of whom could not survive at home without access to their "excess income" for their everyday living expenses.

The Result for Mary

Once Mary's home has been transferred to a protective trust, her liquid assets have been transferred to her children or to a trust, and her monthly "excess income" has been transferred to a pooled income trust, Mary will be eligible to receive Medicaid home care.

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