PROPOSED CHANGES TO THE VA PENSION RULES, VA PENSION TRUST ISSUES, AND A COMPARISON BETWEEN THE MEDICAID AND VA PENSION TRUST RULES

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PROPOSED CHANGES TO THE VA PENSION RULES, VA PENSION TRUST ISSUES, AND A COMPARISON BETWEEN THE MEDICAID AND VA PENSION TRUST RULES

I. Proposed Changes To The VA Pension Rules.

A. The aid and attendance allowance provides benefits for war era veterans and their surviving spouses who require the regular attendance of another person to assist in at least two of the daily activities of living such as eating, bathing, dressing and undressing, transferring, and the needs of nature.

1. The VA pension program is a non-service connected pension which is means-tested and requires meeting the following requirements:

   a. The veteran must be age 65 or older, or permanently and totally disabled for a reason not due to the veteran's own willful misconduct;

   b. There is no age requirement for a surviving spouse to qualify for a widow's pension;

   c. The veteran must have been discharged from service under conditions other than dishonorable;

   d. Certain service requirements must have been met:

      (1) The majority of applicants for this pension benefit entered active duty prior to September 7, 1980;

      (2) The result of this is that the veteran must have served at least 90 days of active military service, one day of which was during wartime;

   e. Net worth must not be excessive; and

   f. Countable family income must be below a yearly limit.

These materials will not address "compensation," i.e., the disability compensation to which a veteran may be entitled if the veteran obtained an injury or disease while on active duty, if the injury was a result of service or was exacerbated by service (see 38 U.S.C. § 101(13); 38 C.F.R. § 3.4). Entitlement to service-connected pension is not barred by the veteran's employment and not affected by earned or unearned income or the value of the veteran's net worth, and the disability compensation is tax-free.

2. The reference to "Aid and Attendance" is in fact a misnomer, since "Aid and Attendance" and "House Bound" are actually additional monetary allowances provided with the pension if the recipient of pension moneys needs the regular aid and attendance of another person or is considered house bound.

   a. Aid and Attendance assistance allowances are also available for service-connected disabilities ("disability compensation") and to a spouse of a service-connected disabled veteran, and an Aid and Attendance allowance is also available to a surviving spouse of a veteran if the surviving spouse is receiving DIC ("Dependents Indemnity Compensation").

   b. There are numerous monetary levels of Aid and Attendance or House Bound allowances available with non-service connected and service-connected disability programs for veterans or their surviving spouses.

   c. There are, essentially, three types of special monthly pension to offset the cost of necessary health care:

(1) Low income pension (this is the VAs equivalent of SSI - the claimant must meet all of the applicable criteria and have limited income and assets).

(2) House Bound - available to a veteran or widow(er) of a veteran who is determined to be disabled and is essentially confined to the home); see 38 U.S.C. § 1502(c) (this requires a single permanent disability rated as 100 percent under the VA schedule and confined to the dwelling, or a 100 percent disability with another 60 percent disability, regardless of whether or not the person is confined to the dwelling).

(3) Aid and Attendance - available to a veteran or widow(er) of a veteran who is blind, living in a nursing home, or needs regular assistance with at least two activities of daily living (walking, bathing, dressing, incontinence care, or eating), or needs regular supervision due to cognitive decline.

3. Pension is based on a maximum yearly income amount called the "Maximum Annual Pension Rate" (MAPR).

a. The claimant (including both the husband and wife that constitutes a household) must be making less than this amount in order to qualify for the benefit.

b. The benefit is the difference between this MAPR and the combined gross household income reduced for medical costs and adjusted by a five percent deductible.

c. This adjusted income is called the "Income for VA Purposes" (IVAP).

d. If the veteran or spouse has a need for the aid and attendance of another person, then the MAPR is higher.

e. If the veteran has no need of the aid and attendance of another person, the veteran's income must be very small in order to meet the income test.

4. Benefit Table.

2015 Maximum Annual Pension Rates (MAPR)
Effective December 1, 2014 - 1.7% Annual Increase

If you are a veteran...	Annual	Monthly
Without Spouse or Child	$12,868	$1,072
No dependents, medical expenses must exceed 5% of MAPR	$ 643	$ 54
With One Dependent	$16,851	$1,404
With dependents, medical expenses must exceed 5% of MAPR	$ 842	$ 70
Housebound Without Dependents	$15,725	$1,310
Housebound With One Dependent	$19,710	$1,642
A&A Without Dependents	$21,466	$1,788
A&A With One Dependent	$25,448	$2,120
Two Vets Married to Each Other	$16,851	$1,404
Two Vets Married to Each Other One H/B	$19,710	$1,642
Two Vets Married to Each Other Both H/B	$22,566	$1,880
Two Vets Married to Each Other One A/A	$25,448	$2,120
Two Vets Married to Each Other One A/A One H/B	$28,300	$2,358

Two Vets Married to Each Other	$34,050	$2,837
Both A/A		
Add for Mexican Border Period or WW1 to any category above	$ 2,923	$ 243
Add for Each Additional Child to any category above	$ 2,198	$ 183

a. The VA pays the difference between the recipient's countable income, less allowable deductions, and the applicable limit.

b. The amount might be referred to as the applicable monthly pension allowance.

5. The net worth limit (or the combined net worth limit in the case of a veteran with a spouse) has always been very difficult to quantify.

   a. No precise figure exists other than that a formal administrative review is undertaken if the beneficiary has a net worth of $80,000 or more.

      (1) There is no specific amount in the regulations.

      (2) The veteran's household needs for maintenance are analyzed and weighed against the assets that can be readily converted to cash, and consideration is given to whether the income from that cash will cover the difference in the household income and the cost of medical care over the care recipient's remaining life span.

      (3) However, this rule is only a suggestion and the final decision is left to the rating representative.

(4) Consequently, the decision has often been subjective, and in some cases a benefit award has been denied for assets around the $20,000 level, or even less.

(5) Some representatives believe that a reasonable rule of thumb is about $40,000 for a couple and about $20,000 for a single individual.

b. The market value of all real and personal property is taken into account (reduced by any mortgages or other encumbrances, and excluding the value of the single family dwelling unit), and excluding the value of personal effects suitable to and consistent with the veteran's reasonable mode of life.

c. Certain educational expenses and compensatory settlement payments are also excluded.

d. Disclaimers of potential income and transfers of property to a relative in the veteran's household are not recognized as reducing the value of the veteran's assets.

e. Net worth is evaluated based on the liquidity of the property, the veteran's medical needs and life expectancy, and certain needs of family members. 38 C.F.R. §§ 3.274-3.276.

6. The veteran's income currently must be less than the maximum applicable pension rate.

a. Income includes payment of any kind from any source, whether recurring or infrequent.

(1) Receipt of a gift of stock would be considered income.

(2) Winnings from gambling, an inheritance, or receipt of a gift of property would be considered income.

(3) Withdrawals from IRAs, 401(k)s and other retirement accounts are considered income, while the funds left in the IRA or other retirement account is considered an asset.

(4) Social Security income and Social Security Disability income are considered income; income from VA compensation, even though it is exempt from income taxes, is considered income for pension purposes, as is income from DIC.

(5) Generally, income that is not consumed and carried over to the next month becomes an asset.

b. Gross income is considered before any deductions for taxes, business losses, etc.

c. Workers Compensation awards and similar payments are considered income, but adjustment may be made for medical, legal and other expenses incident to the injury or collection of payment.

d. Excluded are SSI, welfare payments, contributed maintenance, the VA pension itself, reimbursement for casualty loss, or profit from the sale of property, amounts in joint bank accounts acquired upon the death of the other joint owner, minimal earnings of a child, hardship exclusion from a child's income, payments under a Domestic Volunteer Service Act program like Foster Grandparents or the Retired Senior Volunteer Program, payments under a Department of

Defense survivor benefit annuity, cash surrender value of life insurance, and certain compensatory settlement payments.

e. Accrued interest received on the redemption of United States Savings Bonds is treated as profit on sale and not as income.

f. The sale of property through a private installment contract where the contract is owned by the veteran or a surviving spouse is neither income nor an asset until the principal amount of the loan has been repaid. This is one way in the past that applicants may have been able to convert assets into non-countable assets in order to qualify for the VA pension.

7. A veteran who has no spouse or child and who receives VA domiciliary or nursing home care for more than three months receives a reduced pension of no more than $90 per month. The veteran is not liable to repay amounts received by virtue of the VA's failure to reduce the pension, provided the veteran did not conceal information.

8. Attached as Exhibit "A" is the Quick Reference Guide published by the VA to provide guidance regarding the income and asset rules used for financial assessment purposes.

B. The Veterans Administration (VA) published comprehensive proposed new rules on January 23, 2015 that will (i) establish a new "bright line" net worth limit, (ii) establish a three year "look-back" on transfers of "covered assets" and impose penalties for such transfers, and (iii) revise the rules governing deductibles and unreimbursed medical expenses and income exclusions.

1. The changes are comprehensive and address net worth, asset transfers, medical expenses and income and deductions.
2. The net worth limit will equal the maximum community spouse resource allowance under Medicaid on the effective date of the final rule (currently $119,220; beginning in 2017 the estimated Medicaid resource allowance will be $120,900).
3. The net worth limit will increase by the same percentage as the cost-of-living increase for Social Security benefits.
4. The VA's Notice of Proposed Rule (NOPR) is available at *https://federalregister.gov/a/2015-00297*.

C. Specific changes.

1. Annual income will be added to a claimant's net worth, which is a change from existing law.
    a. If the net worth limit is $119,220, the surviving spouse's annual income is $7,000, and her total assets equal $117,000, adding the spouse's annual income to her assets produces a net worth of $124,000 which exceeds the net worth limitation.
    b. A veteran's assets are defined to include the assets of the veteran as well as the assets of his or her spouse, while a surviving spouse's assets include only the assets of the surviving spouse.
    c. Unlike other federal means-based programs (the SSI and Medicaid programs, for example), VA regulations did not previously prescribe clear net worth limits for pension entitlement - the proposed rules will change this by establishing a "bright line" net worth limit.

2. Ways of decreasing net worth:

   a. The assets may decrease in value.

   b. Annual income may decrease.

   c. Both may decrease.

3. Assets decrease permissibly when a veteran, surviving spouse, child or someone acting in their behalf spends their assets on basic living expenses such as food, shelter, clothing, health care, or education or vocational rehabilitation.

   a. Allowable deductions from income will be applied first to decrease annual income.

      (1) Unreimbursed medical expenses are deducted in calculating the veteran's countable income.

      (2) Veterans who would not have previously qualified may become eligible if they incur increased medical, assisted living, and other health care expenses.

      (3) Deductible expenses may include home care, medications, health insurance premiums, assisted living payments, and adult daycare and similar facilities.

   b. If there are additional expenses that are appropriate to deduct from income, those expenses are permissible reductions in the value of assets.

   c. Current regulations do not define or describe what the VA considers to be a medical expense, which would be an allowable deduction from

the claimant's countable income to decrease the claimant's income, thereby increasing the claimant's benefit entitlement rate.

(1) The Proposed Rule would define and clarify what the VA considers to be a deductible medical expense.

(2) It provides definitions for several terms, including activities of daily living (ADLs) and incidental activities of daily living (IADLs).

d. "Custodial care" means regular assistance with two or more ADLs or assistance because a person with a mental disorder is unsafe if left alone due to the mental disorder.

e. The new rules would provide that, generally, payments to facilities such as independent living facilities are not medical expenses, nor are payments for assistance with IADLs; however, there would be exceptions for disabled individuals who require health care services or custodial care.

f. There would be a limit on the hourly payment rate that may be deducted for in-home attendance.

4. Exclusions from the definition of "assets."

a. The primary residence remains excluded, and if sold, the proceeds will not count if used to purchase another residence within the same calendar year.

b. In recent years the VA has taken a position that if the home is not being occupied by the veteran or the veteran's spouse, it is no longer an exempt asset.

c. The same net worth limit applies when a surviving spouse is seeking pension benefits.

d. Mortgages on the primary residence will not reduce the value of other assets.

e. Personal effects both suitable to and consistent with a reasonable mode of life will be excluded from total asset value.

5. Asset transfers and penalty periods.

a. These are set out at Proposed Rule 38 C.F.R. §3.276.

b. Only the transfer of "covered" assets will be penalized.

(1) A "covered" asset is defined as an asset that "was part of a claimant's net worth, was transferred for less than fair market value, and if not transferred, would have caused or partially caused the claimant's net worth to exceed the net worth limit...".

(2) Therefore, only the amount transferred in excess of the net worth limitation will be subject to a penalty.

(3) The penalty would not be based on the entire amount transferred, but only on the portion that would have caused the net worth to exceed the eligibility limit.

(a) This means that some transfers may not create any penalty at all.

(b) A smaller covered asset amount would result in a shorter penalty period.

c. A transfer for less than fair market value includes the sale, gift or exchange of an asset for less than the fair market value, or the transfer to a trust or purchase of any financial instrument that reduces net worth, including the purchase of an annuity.

6. The look-back period for all transfers is 36 months preceding the date the VA receives an original pension claim or a new pension claim after a period of non-entitlement.

   a. There is a presumption that an asset transfer made during the 36 month look-back period was for the purpose of decreasing net worth in order to qualify for a VA pension benefit.

   b. There is an exception for a transfer by a veteran, the veteran's spouse, or the surviving spouse of a veteran to a trust established for the benefit of a child if (i) the VA has rated the child incapable of self-support pursuant to 38 C.F.R. §3.36, and (ii) there is no circumstance where the trust assets can benefit the veteran, the veteran's spouse or the veteran's surviving spouse.

7. There is a ten year limit on the penalty imposed.

   a. To calculate the penalty, the maximum annual pension rate will be used for veterans and surviving spouses who apply.

   b. A single veteran would use the aid & attendance allowance amount with no dependants; a married veteran would use the aid & attendance allowance with one dependant; and a surviving spouse would use the aid & attendance allowance amount for a surviving spouse taken from the Death Pension Table.

c. The monthly rate is figured by dividing the maximum annual amount by 12 and rounding down to the nearest whole dollar.

(1) The formula is similar to that used by the SSI program.

(2) The pension rate used is referred to as the "maximum annual pension rate" (MAPR), under 38 U.S.C. 1521(d), 1541(d) or 1542 that is in effect as of the date of the pension claim. The penalty is rounded down to the nearest whole dollar.

(3) The MAPRs are located on the VA's website at *http://www.benefits.va.gov/pension/*.

d. The penalty begins the first day of the month following the transfer.

e. If more than one transfer is made, the penalty begins the first day of the month following the last transfer.

(1) The penalty will be recalculated if all of the covered assets are returned before the date of the claim or within 30 days after the date of the claim.

(2) Once calculated, the penalty would be fixed, and return of the covered assets after the 30 day period would not shorten the penalty period.

II. Summary of impact of proposed new rules.

A. The proposed new rules will clarify some issues that currently lead to inconsistent decisions.

B. The rules should reduce claim discretion that often results in unequal treatment.

1. However, the transfer restrictions and resulting penalties will create significant impediments and complexity in regard to filing, processing and qualification.

2. The proposed rules pertaining to annuities and trusts that "would not be in the claimant's financial interest but for the claimant's attempt to qualify..." are vague and potentially problematic.

3. A transfer to an irrevocable income-only trust ("IIOT") would not only be penalizable, but even under the VAs interpretation of existing rules, because the veteran-claimant and/or his or her spouse would be an income beneficiary of the self-settled IIOT, the trust assets would still be treated as available because there was not an "...actual relinquishment of rights in the property and income from the property."

4. For similar reasons, a self-settled "safe harbor" special needs trust would likewise probably be treated as available even if the transfer was not treated as penalizable, which it probably would be unless created by a third party.

5. Veterans will probably need more assistance and pre-eligibility planning in order to qualify for the VA pension.

III. VA Pension Planning Strategies.

A. Common planning strategies for VA pension qualification prior to the proposed changes to the VA pension rules included the following:

1. Gifts were commonly made to reduce "excessive" net worth to someone who did not reside with the veteran or the spouse.

2. Immediate single premium annuities were frequently purchased to convert the assets into an income stream having no value for the purpose of calculating net worth.

   a. It was the VA's general unwritten policy to treat the income from single premium annuities as income for VA purposes.

   b. More recently, the VA has taken the position that certain annuities have cash value and have attributed value to such annuities.

3. Transfers to irrevocable trusts were used, which as outlined above, were frequently problematic:

   a. As a general rule, neither the veteran claimant nor his or her spouse may be an income or principal beneficiary of any self-settled trust for VA pension qualification purposes. There must be an "...actual relinquishment of rights in the property and income from the property."

   b. A transferee would occasionally make a "gift-back" of the income from transferred sources, which if it occurred, would cause the income to be countable under 38 C.F.R. 3.271.

   c. If the trust is a "grantor trust" under IRC § 671 through § 678, problems can result because of the matching of income process undertaken by the VA.

      (1) Since December 2012, the VA no longer requires eligibility verification reports, and instead now coordinates with the IRS and the SSA to verify continued eligibility for pension benefits.

(2) The VA will most likely assume that income from a "grantor trust" is the veteran's (or the surviving spouse's) income which may terminate or compromise pension benefits as a result.

d. The use of a trust protector can be very helpful for VA pension planning and for other asset protection planning purposes to cure what might otherwise be a defective or faulty arrangement.

4. The major problem created by VA qualification planning in the past was that assets were frequently transferred and then rendered unavailable when Medicaid eligibility became an issue.

a. Although transfers were not penalizable for the purpose of VA qualification, when Medicaid eligibility later became important, those transfers rendered the applicant ineligible for Medicaid if the transfer occurred within the applicable look-back period, which currently is five years.

b. In addition, many of the so-called "financial advisors" involved in this planning utilize either immediate-payment or deferred annuities as a way to "invest" the funds, involving annuity payments or annuity access to the donees of the funds that were transferred in order to qualify for the VA pension benefit.

(1) The annuity would incur commissions that generate fees for the financial facilitator, but the use of an annuity was wholly unnecessary and did not create any positive benefit in conjunction with the VA qualification plan.

(2) Further, when the parent later required Medicaid, the funds might not be available, or penalties would be incurred when it was necessary to liquidate the annuitized payments and receive the payment based on present value.

B. The plan that I found to be most effective, although complex, involved a transfer by the veteran to the children or to certain family members, who would then establish a separate, third-party trust utilizing the transferred assets.

1. The trust would be an irrevocable trust established by and for the benefit of the children.
2. Generally, only income could be distributed to the children, and even then usually only to the extent of the income tax liability incurred by the children. The trust was, essentially, a holding vehicle designed to preserve the assets should they be needed if Medicaid qualification later became an issue.
3. Limited distributions for the benefit of the parent would be allowed based on entirely discretionary restrictive criteria.
4. Distributions would generally be in the form of payments made for the benefit of the parent, or to the children to be spent for the benefit of the parent, rather than directly to the parent.
5. The trust, even though irrevocable, would be a "grantor" trust for income tax purposes and the income would be taxable to the children; the trust would contemplate using the trust funds to pay the children's applicable portion of the tax or to reimburse the children for the taxes incurred.

6. The trust would include an "escape clause" so that the trust could be undone if it became necessary to do so and found to be in the parent's best interest or if required to assure qualification for Medicaid or other public benefits.

    a. The assets would all be retained and would be traceable.

    b. If the trust was undone, there would be a "gift-back" of the trust assets, thus eliminating the Medicaid penalty, or at least a substantial part of it.

    c. The funds could then be used in the appropriate way, utilizing an appropriate Medicaid qualification strategy, to qualify the parent for Medicaid.

    d. If the trust was established more than five years prior to the Medicaid application, then the transfer would not need to be disclosed.

    e. One issue to be considered is the potential capital gain impact resulting from the transfer of appreciated assets; the donor's basis would become the tax basis of the donee for the purpose of determining capital gain, which would result in potentially taxable capital gain upon the subsequent sale of the gifted property.

7. This type of plan is complex, but the cost of implementing it is probably less in most instances than the commission that would be earned from the sale of a typical $100,000 annuity!

IV. VA Pension Trust Rules.

A. There is very little guidance available from the VA regarding the effect of certain trusts on pension benefits.

    1. Office of General Counsel Opinion 33-97.

a. This opinion clearly states that a transfer to a trust, where the terms of the trust provide for the grantor's support, will cause the trust assets to be counted in the net worth calculation.

b. In this case, the surviving spouse established an irrevocable trust naming her child as the trustee. The terms of the trust provided in part that "some or all of the income and principal of the trust fund may be paid by the trustee to or for the benefit of only the surviving spouse's "special needs...".

c. This trust was essentially a self-settled special needs trust, which would likewise not be effective for Medicaid eligibility purposes either unless structured to fall within one of the "safe harbor" rules.

d. However, a testamentary SNT per OGC 72-90 should be effective except to the extent the trust assets are actually distributed or made available to the veteran.

e. This opinion stated that the VA should include all of the trust assets in determining net worth if the trust assets are available for use for the claimant's support. In this case, because the trust permits the use of trust assets for the surviving spouse's benefit, all trust assets are deemed to be available and countable in determining net worth.

2. Office of General Counsel Opinion 73-91.

a. This is one of the few favorable OGC opinions related to trusts established by a veteran claimant. While receiving benefits, the veteran received a payout of $80,000 from a life insurance policy of which he was the beneficiary, and also inherited some stock.

b. The veteran proposed to create an irrevocable trust of which the veteran was the trustee and his grandchildren were proposed beneficiaries.

c. Although the inheritance counted as income to the veteran, once the assets were transferred to the trust, the trust corpus was not part of the veteran's countable net worth.

d. Specifically, this opinion determined that assets transferred to an irrevocable trust for the benefit of the veteran's grandchildren, where the veteran is the trustee and has retained no right or interest in the property or the income and cannot exert control over these assets for the veteran's own benefit, would not be counted in determining the veteran's net worth for pension purposes. Further, trust income would not be considered income of the veteran.

e. There must be an "...actual relinquishment of rights in the property and income from the property."

f. The facts provided to the General Counsel's office did not state whether the veteran's grandchildren lived with him – a fact noted by General Counsel as one that may have caused a different outcome. Because a transfer to a relative residing in the same household is disregarded, the outcome would likely be different if the beneficiaries of the trust resided with the veteran.

g. This kind of an irrevocable trust established for the benefit of a third party would likewise not affect the Medicaid eligibility of the grantor, although the establishment of the trust and the transfer of assets

within five years of the date of the Medicaid application would be penalized, which would result in the Medicaid program not paying for the nursing home care or the otherwise covered waivered services during the applicable Medicaid penalty period. However, the grantor should not be the trustee.

h. The establishment of such a trust would now be subject to a penalty for VA pension qualification purposes.

3. Office of General Counsel Opinion 72-90.

a. In this case the veteran-claimant was the beneficiary of a testamentary trust. The trust provided that the trustee could distribute funds for the veteran's comfort, but not as a substitute for support and maintenance to which veteran was entitled from other sources.

b. The opinion recognized that the veteran did not hold legal title to or control of the trust property. Thus, only the portion of the trust property, including trust-related income, that has actually been made available for the veteran's use, is, at the time of its allocation, countable for purposes of the income and net-worth provisions in determining pension benefits.

c. Thus, a properly drafted, fully-discretionary third party trust, of which the veteran is a beneficiary, should not affect pension qualification until such time as trust assets have been distributed or made available to the veteran.

d. In the context of Medicaid, all trusts must be examined, including testamentary trusts, to determine whether or not the assets will be deemed to be "available" to the beneficiary.

B. The following would appear to represent a general summary of the current VA trust rules:

a. A trust established by a third party which provides for the veteran's support, whether established by the veteran's spouse or another third party, would be treated as a resource per OGC Opinion 33-97.

b. A special needs trust established by a third party, except perhaps the veteran's spouse, should not affect VA pension qualification except to the extent that trust assets are distributed or made available to the veteran.

c. A revocable trust would disqualify the veteran because the assets would be deemed to be available.

d. An irrevocable trust established by the veteran or the veteran's spouse, if either of them is a beneficiary, would cause the trust assets to be deemed to be available to the veteran because there would not have been an "actual relinquishment of rights in the property and income from the property" per OGC Opinion 73-91, and would also presumably be subject to a transfer penalty.

e. A third-party *inter vivos* trust, unless established by the veteran's spouse, should not be treated as a resource except to the extent that the assets are available for the veteran's support, unless assets are

actually distributed to or made available to the veteran, per OGC Opinion 72-90.

V. Indiana Medicaid Trust Rules.

A. The Omnibus Budget Reconciliation Act of 1993 (OBRA 93) applies to trusts established on or after August 11, 1993.

1. The pre-OBRA 93 rules apply to trusts established prior to August 11, 1993 and to assets placed into a trust after August 11, 1993 provided that the trust was established on or before August 11, 1993.

2. The OBRA 93 trust rules are established by 42 U.S.C. §1396p(d) and are covered by IHCPPM §2615.75.10.

   a. The regulations found at 405 IAC 2-3-2 implementing the OBRA 93 rules restate the federal requirements and do not provide additional guidance.

   b. HCFA Pub. 45-3, Transmittal No. 64 (Nov. 1, 1994) is contained in §3259 of the CMS State Medicaid Manual.

3. OBRA 93 applies to any non-testamentary trust funded with the applicant's or the applicant's spouse's assets established on or after August 11, 1993 if the trust is established either by the applicant or recipient or his or her spouse, a person (including a court or administrative body) with legal authority to act in place of or on behalf of the applicant or the applicant's spouse, or a person (including a court or administrative body), acting at the direction or upon the request of the applicant or the applicant's spouse.

B. Testamentary trusts set up by a third party are not subject to the OBRA 93 rules.

1. The impact of such trusts will depend on whether the assets of the trust are deemed to be "available." See IHCPPM §2615.75.20.

2. If the trustee has the sole discretion to distribute funds, the trust should not be counted as a resource.

C. Revocable trusts.

1. A trust is considered to be revocable if there are any circumstances when it can be revoked.

2. The corpus of a revocable trust is an available resource.

3. Payments to a third party which are not for the benefit of the individual are treated as penalizable transfers when they are paid to the third party, while "payments from the trust" to or for the benefit of the individual are counted as income to the individual. See IHCPPM §2615.75.10 and 42 U.S.C. §1396p(d)(3)(A).

4. In Indiana, if real estate is in a revocable trust, it is still treated as real estate, and the rules pertaining to real estate will be applied to that property. However, §3259.6(f) of the CMS State Medicaid Manual provides that placing a home of an institutionalized person in a trust results in the home being a countable resource.

D. Irrevocable trusts.

1. 42 U.S.C. §1396p(d)(3)(B)(i) states:

> [I]f there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus

from which, payment to the individual could be made, shall be considered resources available to the individual....

2. 42 U.S.C. §1396p(d)(3)(B)(ii) states:

[A]ny portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of the establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual....

E. See VI. for information relating to irrevocable income-only trusts ("IIOTs").

F. Trusts for disabled persons under 42 U.S.C. §1396p(d)(4)(A), (B) and (C), so-called "safe harbor" trusts, are beyond the scope of this presentation, but refer to Exhibit "B" for a chart summarizing various types of trusts and the probable VA and Medicaid impact.

VI. Irrevocable Income-Only Trust Developments in the Context of Asset Protection.

A. *Ada Brown v. Indiana Family and Social Services Administration*, 2015 Ind. App. LEXIS 717 (Ind. Ct. App., No. 87A01-1501-PL-38, Nov. 18, 2015).

1. Ada and Roy Brown transferred their home to a trust in 2000 and shortly thereafter made the trust irrevocable.

a. Ten years later, and two years after Ada moved to a nursing home, the trust sold the home for $75,000.

b. In 2012 Ada applied for Medicaid benefits and submitted documentation that the house had sold for $75,000.

c. The Indiana Family and Social Services Administration ("FSSA") found Ada eligible for Medicaid benefits, but imposed a transfer penalty based on the sale of the home.

d. In calculating the penalty, the FSSA valued the home at $91,900, its assessed value for tax purposes.

e. Ada appealed the imposition of the penalty; the ALJ and the Trial Court affirmed, and Ada appealed.

2. The Court of Appeals reversed.

a. It held that the evidence showed that the proceeds from the sale of the house were properly placed back in the trust and that the fair market value of the house was $75,000.

b. The Court of Appeals reversed the imposition of the transfer penalty.

c. FSSA asked the Court of Appeals to remand the matter back to the agency for a redetermination of eligibility, to which the Court of Appeals declined because the issue was waived, i.e., the FSSA had found her to be eligible.

3. The Court of Appeals held that the State should not have imposed a transfer penalty because the evidence showed that the house sold for its fair market value.

a. The Court of Appeals gave a general summary of the history and chronology of the Medicaid program under 42 U.S.C. §1396 et seq.

b. In this case, the trust was established in 2000 and shortly thereafter it was made irrevocable, and the house was not sold until ten years later.

(1) The FSSA had found Ada eligible for Medicaid but had assessed a transfer penalty.

  (a) Both the ALJ and the Trial Court affirmed that decision based on the notion that the transfer of the assets occurred when the house was sold in 2010, which was within the 60-month look-back period from the Medicaid application date.

  (b) The FSSA admitted that not only the FSSA, but also the ALJ and the Trial Court, had erred and did not analyze this case properly under the applicable statutes and regulations.

(2) The FSSA nevertheless argued that Ada should be deemed to be ineligible at the time that she applied for Medicaid benefits because the trust held $75,000 that was available to her under the Medicaid trust regulations, or alternatively, that there should be a penalty, but a smaller one than the penalty imposed, because the house was sold for $75,000, which was $16,900 less than the $91,900 fair market value of the property according to the Warrick County Assessor's records.

(3) The Court of Appeals stated in *dicta* that the trust assets would be deemed available to Ada because she was able to benefit from the trust.

  (a) However, since eligibility was never an issue at the agency level, or with the ALJ or the Trial Court, and

instead since the transfer penalty was the issue, the court declined to overrule the eligibility determination of the FSSA.

(b) It should be noted that the court erroneously stated in its *dicta* that the funds were available to Ada, unless the trust terms were such that Ada would have been entitled to more than the income from the trust assets, which would be unusual for an income-only trust.

i) The actual terms of the trust were not fully disclosed by the Court of Appeals decision.

ii) In a typical income-only trust, only the income is available, and is actually paid out, which would be treated as income as received, but not as a resource affecting Medicaid eligibility unless the income has not been disposed of by the Medicaid recipient by the end of the month of receipt.

B. _Nadeau v. Thorn_ (Mass. Super. Ct., No. 14-DV-02278C, Dec. 30, 2015).

1. A Massachusetts trial court ruled that a Medicaid applicant's irrevocable trust was an available asset because he retained the right to use and occupy the property that was placed in the trust.

a. In 2001, Lionel Nadeau and his wife created an irrevocable trust and transferred their house into the trust. The trust provided that the Nadeaus had the right to use and occupy the house, which they did

until Mr. Nadeau entered a nursing home. In 2014, Mr. Nadeau applied for Medicaid benefits. The state considered the trust a countable asset and denied benefits.

b. Mr. Nadeau appealed. The state affirmed the denial of benefits, ruling that the trust was an available asset because he was able to use the property in the trust during his lifetime. Mr. Nadeau appealed to the court, arguing that his home could not be considered available unless the trust gave him a right to some sort of payment.

2. The Massachusetts Superior Court affirmed, holding that the trust was an available asset.

a. The court ruled that while state regulations may require an asset in an irrevocable trust to be both available and payable, HCFA Transmittal 64 provided that payment may include non-cash disbursements, including the right to use and occupy real property.

b. Although this is a trial court decision, and not an Indiana decision, it may indicate the trend that is developing in the area of irrevocable trusts used for the purpose of asset protection.

3. This case arose out of an action for judicial review of a Medicaid decision.

a. The residence was transferred to the trust on the date that the trust was created.

b. The Nadeaus continued to live in the property for more than 13 years until Mr. Nadeau was admitted to a nursing facility on April 1 of 2014.

(1) MassHealth treated the residence as an available asset inside the trust based on its assessed value.

(2) Because the Nadeaus could use the property either to occupy or to rent and receive the income, the property was treated as "available" for MassHealth long-term care qualification purposes.

c. Under applicable Massachusetts law, property held in an irrevocable trust is a countable asset where it is "available according to the terms of the trust."

(1) The home was treated as "available" because the trust's express terms reserved their right to live there.

(2) Mr. Nadeau argued that the home should not be considered "available" unless there were circumstances that gave him the ability to receive some form of payment, such as from the proceeds of the sale.

(a) His argument was based on the "any circumstances" test described in 42 U.S.C. §1396p(d)(3)(B)(i), i.e., if there is any state of affairs at any time during the operation of the trust that would permit the trustee to distribute the trust assets to the grantor, those assets will count in calculating the grantor's Medicaid eligibility.

(b) The court relied on HCFA Transmittal 64 issued by the Health Care Financing Administration (HCFA) which defined "payment" broadly as: "any disbursal from the corpus of the trust or from income generated by the trust which benefits the party receiving it. A payment

may include cash, as well as non-cash or property disbursements, such as the right to use and occupy real property." Medicaid Manual HCFA Transmittal 64, § 3259.1(A)(8).

(3) The court held that Mr. Nadeau's right to use and occupy the home was a form of payment under HCFA Transmittal 64 and was a countable asset even if the applicable regulations required it to be both available and payable to him.

d. Various commentators have questioned the court's holding in _Nadeau_.

(1) The applicable portion of the Massachusetts Medicaid Regulations should not be read in isolation and should be read as a part of the regulations as a whole.

(2) In their entirety, the term "available" does not mean "physically available," but rather it refers to whether the trustee has discretion to distribute the trust principal under any circumstances to or on behalf of the applicant.

(a) Numerous decisions have confirmed that because the right of an applicant to use and occupy property owned by the trust does not translate into the ability of the trustee to distribute any legal interest in the property to the applicant, the right to use and occupy alone does not make an asset countable.

(b) Commentators have also suggested that the court erroneously referred to a case holding that the home was “available,” when in fact the case was based on a number of factors, including a provision by which the trustee could terminate the trust and distribute the principal to the beneficiaries of the trust.

(c) Commentators have also suggested that HCFA Transmittal 64 is clearly inconsistent with the plain language and purposes of the relevant statute.

i) 42 U.S.C. §1396p(d)(3)(B)(1) applies only when a payment could be made to an individual.

ii) The purpose of the applicable regulation is clear: if there are any circumstances under which the principal can be paid to the applicant, that money should be used to pay for the cost of nursing home care.

iii) The right to use and occupy property cannot accomplish this goal.

iv) Unlike a life estate interest, even if the real estate is sold, the holder of the use and occupancy right would be entitled to no portion of the proceeds.

v) There must be circumstances under which the principal can be paid to the applicant, and then used by the applicant to pay for care.

C. *Beware of Irrevocable Income-Only Trusts In Medicaid Planning*, Estate Planning, (May 2016, Vol. 43, No. 5).

1. This recent article analyzes a number of the Massachusetts fair hearing decisions and court cases pertaining to IIOTs.

2. The Massachusetts experience may represent a harbinger of a developing trend in the area of irrevocable trusts:

   a. The right to "use and occupy" real estate is increasingly being treated as tantamount to ownership; it would be better to establish a limited right in the nature of a lease through an occupancy agreement which is very clearly limited and which requires the occupant to pay, in lieu of rent, all expenses associated with the right of occupancy (taxes, insurance, routine maintenance and repairs, utilities, etc.).

   b. Trusts that permit termination under certain conditions and which would require that the property be distributed to the remainder beneficiaries rather than to the holder of the income interest would tend to substantiate the efficacy of the trust and the limited nature of the grantor's interest. It should be very clear that the "grantor" is not a beneficiary who will receive assets in the event of the termination of the trust and the distribution of trust assets.

c. The trust should specifically prohibit the distribution of principal, and should probably not mandate that non-productive property be sold or otherwise converted to income-producing assets.

d. The trust should probably not specifically refer to the possibility of making "loans" from the trust which might be used for the benefit of the grantor, but if in fact such transactions occur, they should be well documented. I have used IIOTs in many instances involving loans made to the grantor to make up for an insufficiency in funds during the penalty period or to meet other needs of the incapacitated grantor.

e. If a power of appointment is used, which will apply in most instances, it should be a specifically limited power of appointment and not one which would appear in any way to unduly or inappropriately advantage the grantor or apply undue pressure to the trustee.

f. The right to remove the trustee should be limited to specifically-defined circumstances, i.e., misconduct, negligence, inconvenience of location, etc.

g. Steer clear of language commonly used in special needs trusts (e.g., that the trust is for the "sole benefit" of the grantor, or that the income can be used for "special needs" circumstances, etc.); income should always be distributed and under no circumstances accumulated, and under no circumstances should principal be distributed or available for distribution.

h. Rather than allowing the trustee to determine that which is principal and that which is income, it should be very specifically stated that

capital gains and capital gain distributions will be treated as principal and not as income.

i. Principal should not be available for distribution or in fact distributed to anyone during the grantor's lifetime and until the termination of the trust.

D. Federal and Indiana rules regarding irrevocable trusts:

1. 42 U.S.C. § 1396p(d)(3)(B)(i) states:

> If there are any circumstances under which payment from the trust could be made to or for the benefit of the individual, the portion of the corpus from which, or the income on the corpus from which, payment to the individual could be made shall be considered resources available to the individual...

2. 42 U.S.C. § 1396p(d)(3)(B)(ii) states:

> Any portion of the trust from which, or any income on the corpus from which, no payment could under any circumstances be made to the individual shall be considered, as of the date of establishment of the trust (or, if later, the date on which payment to the individual was foreclosed) to be assets disposed by the individual...

3. The Indiana rules are set forth in the Indiana Health Care Program Policy Manual (IHCPPM) beginning at § 2615.75.10.

a. If a trust is established so that neither the corpus nor the income can under any circumstances benefit the individual, then the trust corpus

will not be treated as an available resource and will be treated as having been transferred when the trust was established or funded.

b. The effect of an "income only" trust, where the individual cannot benefit from the corpus but will receive the income, is less clear from the language.

c. CMS has affirmed that if no portion of the trust corpus can be distributed, the corpus will not be counted as a resource to the individual.

d. Thus, no part of an "income only" trust should be counted as a resource, but instead the trust corpus will be treated as having been transferred when the trust was established.

e. Actual payments to the Medicaid recipient **will** be counted as income in the Medicaid budgeting process.

4. Those portions of an irrevocable trust which can under some circumstances be used to benefit the individual are treated as an available resource unless and until they are transferred to a third party.

   a. Those portions of an irrevocable trust which cannot ever be used to benefit the individual will not be considered as an available resource but instead will be considered to have been transferred when the trust was established, or if later, the date upon which payment to the individual was foreclosed.

   b. The result of this is that a trust that is labeled as "irrevocable" does not by itself determine whether the assets in the trust are available and countable as a resource.

c. One needs to review the language of the trust to see if there are any circumstances under which the grantor can receive a distribution from the assets.

d. To the extent the answer is yes, the assets are available and countable as a resource.

e. Attached as Exhibit "C" is a copy of IHCPPM § 2615.75.10.

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