Nuts and Bolts of Half-a-Loaf Divestment Planning

Amy Rombyer Tripp
Chalgian & Tripp Law Offices PLLC
Jackson

I. Introduction

Half-a-loaf planning is an asset protection strategy that involves transferring a portion of the applicant’s resources thereby creating a divestment penalty period of ineligibility. The remaining portion of the resources are converted into income to pay the care costs during the divestment penalty period of ineligibility.

The goal is to create a monthly income steam that will last for as long as the penalty period. Done correctly, when the penalty period ends, the income stream ends, and the patient-pay amount is based on the income of the applicant without the supplemental income that was generated only to get through the penalty period.

The amount of resources transferred depends on the applicant’s income and the cost of care, more often then not the applicant actually transfers more then half of the resources.

Half-a-loaf planning is complicated. It is easy for planners to make mistakes, and hard for Department of Human Services (DHS) caseworkers to understand and accept.

Who is our Half-a-Loaf Client? Most often this strategy is utilized by the single person applicant. Although it can be useful to consider for married couples in a second marriages in which the couple has kept separate assets, and for couples in cases when both husband and wife are in long term care (LTC). Another use of half-a-loaf strategy is to create income to pay for penalty periods resulting from previous transfers.

A. Divestment

Divestment is a “transfer of a resource by a client or spouse” for less then fair market value that is within the look-back-period (BEM 405 page 1). The transferred amount is used to calculate the divestment penalty period of ineligibility (BEM 405 page 3).

Baseline Date. Although in most cases the penalty divisor is the divisor for the year of the application, that is not always the case. The divisor is established by the “baseline date.” The baseline date is the first date that the applicant was eligible for Medicaid and in LTC, approved for waiver, eligible for home health services or eligible for home help services (BEM 405 page 5). An applicant’s baseline does not change.
B. How to Calculate the Penalty Period

The penalty period is computed by dividing the total amount divested during the lookback period by the average monthly private cost of long term care also known as the divestment divisor. For 2013 that divisor is $7,631.00. The result is the number of months and days an applicant is ineligible for Medicaid LTC benefits. A penalty period is starts when the applicant is financially eligible for Medicaid and actually in LTC, home health, home health or MIChoice Waiver. In order for a month to be considered a penalty month the applicant must have unpaid medical expenses.

BEM 405 page 10

The penalty is applied to the months (or days) an individual is eligible for Medicaid and actually in LTC, Home Health, Home, Home Help, or the MIChoice Waiver. The divestment penalty period cannot be applied to a period when the individual is not eligible for Medicaid for any reason (that is the case closes for any reason or is eligible for Medicaid but is not in LTC, Home Help, Home Health, or the MIChoice Waiver. Restart the penalty when the individual is again eligible for Medicaid and in LTC, Home Help, Home Health or MIChoice Waiver. When a medical provider is paid by the individual, or by a third party on behalf of the individual, for medical services received, the individual is not eligible for Medicaid in that month and the month is not a penalty month. That month cannot be counted as part of the penalty period. This does not include payments made by commercial insurance or Medicare.

Note: An individual is not eligible for MA in a month they have pre-paid for LTC. Because federal law directs that a resident in a nursing facility must have access to all monies held by the facility for the resident, count the money held by a nursing facility as cash.

II. The Strategy

For the half-loaf strategy to work successfully the non divested resources need to be converted to an income stream to pay for the nursing home expenses during the penalty period. There are two conversion options to consider: the commercial annuity or the private promissory note.

A. Short Term Commercial Annuity

Purchasing a Medicaid qualified annuity is treated as the conversion of an asset, not a divestment.

BEM 401 page 4&5

Converting countable resources to income through the purchase of an annuity or the amendment of an existing annuity on or after 09/01/05, is considered a transfer for less than fair market value unless the annuity meets the conditions listed below:

- Is commercially issued by a company licensed in the United States and issued by a licensed producer (a person required to be licensed under the laws of this state to sell, solicit, or negotiate insurance), and
- Is irrevocable, and
- Is purchased by an applicant or recipient for Medicaid or their spouse and solely for the benefit of the applicant or recipient or their spouse, and
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- Is actuarially sound and returns the principal and interest within the annuitant’s life expectancy, and

- Payments must be in substantially equal monthly payments (starting with the first payment) and continue for the term of the payout (no balloon or lump sum payments).

- An annuity purchased or amended **on or after February 8, 2006** must name the State of Michigan as the remainder beneficiary, or as the second remainder beneficiary after the community spouse or minor or disabled child, for an amount at least equal to the amount of the Medicaid benefits provided. The naming of the state in the first or second position must be verified at application or redetermination. An annuity that does not name the state as the remainder beneficiary is a divestment of the total purchase price.

**Practice Tip:** If the applicant dies before the conclusion of the annuity the State of Michigan will not collect as beneficiary as the applicant has no LTC costs given that the applicant was still private paying and in the divestment penalty.

**Practice Tip:** There are almost no commercial companies who offer an annuity for less than two years. Because of the immediate payback there is a fee of at least $1000.00 or more for the purchase of the annuity.

B. Promissory Notes

The second option is a promissory note. If the note complies with BEM 400 page 30 as set forth below then the conversion of resources to the note is not divestment and the note is not considered a resource.

All money used to purchase a promissory note, loan, or mortgage is counted as a divestment unless all of the following are true:

- The repayment schedule is actuarially sound; and

- The payments are made in equal amounts during the term of the agreement with no deferral of payments and no balloon payments; and

- The note, loan, or mortgage must prohibit the cancellation of the balance upon the death of the lender; see Uncompensated Value in **BEM 405** to determine the value.

**Note:** The payments from a note that meets these requirements are countable unearned income.

The value of a promissory note, land contract or mortgage is the amount it can be sold for in the holder’s geographic area on short notice (usually at a commercial discount rate) minus any lien on the property the holder must repay. If the note meets the requirements listed above and also states that it is non-salable and non-transferable, then the note itself is not a countable asset, but the payments are countable unearned income.

**Practice Note:** Using promissory notes are challenging mainly because of the risk that family members who are obligated to make the payments on the note (once they have the funds) will not make the required payments. In addition some practitioners have encountered challenges from DHS with the use of promissory notes. It is this presenter’s practice to only use a note for short term penalties (3 months or less).
C. **Income Eligibility**

The key to a successful half loaf calculation is making sure that the applicant is income eligible for Medicaid and remains income eligible for the length of the penalty period. Income eligibility exists when the applicant’s income does not exceed their care costs. Therefore it is necessary to leave some unpaid medical expenses otherwise known as our “shortfall.” If the nursing home rate is $220 per day then we have a monthly cost of $6,600.00 (30 days). The total GROSS income (applicant’s usual sources of income from Social Security and pension plus the income derived from the annuity or promissory note) should be below $6,600.00. This presenter takes a conservative approach by establishing shortfall of at least $300.00. The decision to use $300.00 is to assure that there is at least one full day of care that is unpaid.

Other practitioners deduct Medicare premiums, health insurance premiums, co-pays and other predictable medical monthly expenses in an attempt to reduce the monthly shortfall. If those additional expenses are being used in the calculation, be prepared for the possibility of having to deal with the DHS caseworker wanting to process the monthly income eligibility with deductible rules. In other words, if the applicant’s monthly nursing home expense alone exceeds the gross monthly income then income eligibility occurs on the first day of the month. If you choose to be more aggressive in the shortfall planning then be prepared for potentially having DHS start your penalty on a different day of the month per BEM 545 page 1.

When one of the above does not equal or exceed the group’s excess income for the month tested, income eligibility begins either:

- **The exact day of the month** the allowable expenses exceed the excess income.
- **The day after the day of them month** the allowable expenses equal the excess income.

**Practice Tip:** Avoid the issue of allowable expenses by just using the nursing home daily rate. It is not worth arguing with a caseworker about what is allowable. Our clients do not wish to pay for appeals. Always remember the quote from our Elder Law Godfather John Bos, “Pigs get fat and hogs get slaughtered.”

D. **Both Spouses in the Nursing Home**

Whether the penalty is split between spouses depends on when the transfer occurred. For transfers that occur prior to an admission and eligibility of the first spouse the penalty is split. However, if one spouse enters the facility becomes Medicaid eligible and then the community spouse subsequently transfers resources and then applies the example seems to suggest the spouse one remains eligible and only spouse two is penalized, thereby allowing for half-loaf planning for the second spouse.

BEM 405 page 12

**Spouses Sharing a Penalty**

A client can be penalized if he or his spouse divests. The penalty is imposed on whichever spouse is in a Penalty Situation; see BEM 211, MA Group Composition. If both spouses are in a penalty situation, the penalty period (or any remaining part) must be divided between them.
Example: Mr. and Mrs. Brown divested themselves of assets prior to Mr. Brown entering a LTC facility and applying for Medicaid. Mr. Brown is in LTC and under a divestment penalty for 24 months. When Mrs. Brown enters the facility 6 months later, the remaining 18 months of Mr. Brown’s penalty are divided between them, giving Mr. and Mrs. Brown each 9 months of the penalty still to complete. If either Mr. or Mrs. Brown die before they complete their penalty the remainder of their penalty is transferred to their spouse.

Example: Mr. Brown enters a LTC facility and applies for Medicaid. He is found eligible for Medicaid. During the presumed asset eligibility period Mrs. Brown transfers Mr. Brown’s assets to herself and then transfers the assets to her children (the first transaction is permitted the second transaction is divestment). Mrs. Brown then enters the LTC facility. Mrs. Brown incurs the investment [sic] penalty.

III. Miscellaneous Considerations

Half-a-loaf strategy planning is not a simple as it may sound. There are other items that can complicate the plan. A successful half-a-loaf will address these other issues.

A. The Shortfall Amount

It is important to understand there is a shortfall that will consist of the nursing home costs, insurance premiums, prescriptions and other personal or home costs. The longer the penalty period the greater the total cost of the shortfall. There needs to be a plan for covering those expenses. Initially, the $2000 kept in the client’s bank account will cover short term penalty periods but will not cover larger transfers that may result in longer penalties. Exempt assets of lesser value such as vehicle may be sold and can be used to cover the shortfall.

B. Who Receives the Divested Resources?

Another issue to consider is where the divested assets should be placed. When there are multiple beneficiaries, it is this presenter’s practice to create an irrevocable trust that will hold title to the divested assets. Drafting these documents can be tricky, as they will be reviewed closely by DHS. It is most critical that such trusts not provide any beneficial interest to the Medicaid applicant.

C. Authority

Does the applicant have capacity to understand the strategy and provide direction with regards to the divested resources? Does the applicant have a Durable Power of Attorney that allows for gifting? Does the Durable Power of Attorney require that the agent honor the existing estate plan? If there is a lack of capacity and no clear authority then prior to engaging in any half-loaf planning a court order should be obtained.

D. Making the Numbers Work

In most cases divested assets and the amount used to purchase the annuity won’t come out even, so the calculation requires some extra math. A mistake that is frequently made is unequal payments when the practitioner uses a promissory note. For both the commercial annuity and the promissory note DHS policy requires equal monthly payments in order for the conversion to be considered unearned income and not a divestment. This becomes especially tricky when one of the following situations arises:
1. Medicare and/or insurance paid a partial month
2. Applicant has Medicare but no Medigap insurance policy which results in different amounts of the cost of LTC.
3. Subsequent hospitalizations which may reduce payments to the nursing facility or trigger more Medicare benefits.

**Practice Tip:** For a partial paid month, applicant may pay all but $300 of the outstanding balance during the month of application rather than attempting to create an income payment for the first month of divestment. This allows for the month of application to be used as a divestment penalty month.

**Practice Tip:** If applicant is in the middle of a penalty period and is hospitalized this may result in additional Medicare covered time which reduces the medical cost and causes the monthly income to be greater than the medical expenses. Per BEM 405 page 10 the Medicare payments do not interrupt a penalty period. However, the excess income will need to be addressed to maintain asset eligibility.

E. **Application**

The application needs to provide complete verification of all the transfers and the complete documentation of the commercial annuity or promissory note. This presenter provides exhibits that document the policy manual items that support this strategy and calculates the penalty months for the caseworker. Further, it is helpful to remind the caseworker to process the application for Medicaid with a “spenddown” and to start the divestment penalty. If processed correctly, the applicant should be approved for Medicaid with a deductible and denied for LTC Medicaid for the correct number of penalty months.

**Practice Tip:** Once the penalty has expired, it is good practice to send a letter to the caseworker reminding them that the penalty has expired and the applicant is now eligible for LTC Medicaid.

F. **MIChoice Waiver and PACE**

It is very difficult to engage in half-loaf planning for individuals in the MI Choice Waiver or PACE programs. This area continues to be developing as these programs expand and options for half-loaf or other strategies in these cases will likely develop.

IV. **Case Study #1**

A. **Facts**

Nursing Home Cost (NHC) $235/day x 30 days = $7,050.00
Gross Monthly Income (GMI) $2,184.00
Total Assets: $52,612.00
Medicare & Gap Insurance Payments $250 per month
2013 Divestment Divisor $7,631.00
B. Formula

NHC $7,050.00.
GMI $(2,184.00)
Shortfall $4,866.00
Monthly Unpaid Medical $(300.00)
Monthly Annuity/PN $4,566.00

Annuity Pmt $4,566.00
Monthly Gift $7,631.00
Total $12,197.00

Total Assets $52,612.00/
Divided by Total pmts needed $12,197.00
4.3135 months

C. Calculation

Beginning Balance March 1 $52,612.00
March 2013
Partial Pay NH $6,750.00
(Total NH Monthly cost minus $300 unpaid medical cost)
Monthly Gift $7,631.00
Total March Cost $14,381.00
April 2013 Beginning Balance $38,231.00
Payment from Annuity/PN $4,566.00
Monthly Gift $7,631.00
Total April Cost $12,197.00
May 2013 Beginning Balance $26,034.00
Payment from Annuity/PN $4,566.00
Monthly Gift $7,631.00
Total May Cost $12,197.00
June 2013 Beginning Balance $13,837.00
Payment from Annuity/PN $4,566.00
Monthly Gift $7,631.00
Total May Cost $12,197.00

Total Balance remaining in bank account in March $1,640.00
Total Gifted Resources = $30,524.00
Payment to Annuity or Promissory Note = $13,698
Partial Payment to NH March = $6,750.00

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Short Fall \((300 + 250) = 550 \times 3 = 1650.00\)
This example presumes legal fees were prepaid before beginning the calculation.

V.  Case Study #2

A.  Facts
Nursing Home Cost (NHC) $236/day x 30 days = $7,080.00
Gross Monthly Income (GMI) $1,192.00
Total Assets: $229,350.00
Medicare & Gap Insurance Payments and Part D $363.00 per month
2013 Divestment Divisor $7,631.00

B.  Formula

\[
\begin{align*}
\text{NHC} & \quad $7,080.00. \\
\text{GMI} & \quad ($1,192.00) \\
\text{Shortfall} & \quad $5,888.00 \\
\text{Monthly Unpaid Medical} & \quad ($300.00) \\
\text{Monthly Annuity/PN} & \quad $5,588.00 \\
\text{Annuity Pmt} & \quad $5,588.00 \\
\text{Monthly Gift} & \quad $7,631.00 \\
\text{Total} & \quad $13,219.00 \\
\text{Total Assets} & \quad $229,350/
\end{align*}
\]
Divided by Total pmts needed $13,219.00
17.35 months

C.  Calculation

Beginning Balance March 1 $229,350.00
March 2013
\[
\begin{align*}
\text{Partial Pay NH 5 days} & \quad $1,116.00 \\
(236x6=1,416-300 unpaid medical cost) & \\
\text{Legal Fees} & \quad $6,000.00 \\
\text{Annuity Fee} & \quad $1,000.00 \\
\text{March Insurance Pmts} & \quad $300.00 \\
\text{Total March Costs} & \quad $8,416.00 \\
\end{align*}
\]
$220,934.00

PMT to Commercial Annuity
$5,588 x 16 months = $89,408.00
Divested Resources
$7,631 x 17 months = $129,727.00

Ending Balance March 31st
$1,799.00

Medicaid eligible March 1, 2013

LTC divestment penalty beginning March 2013 through July 31, 2014.
Annuity pmts starting April 1, 2013 through July 1, 2014
Issue: Short Fall (300 + 300) = 600 x 16 = $9,600.00