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Elder law:

Planning for long-term care without spending a lifetime of savings

With more than 40 million Americans age 65 or older, seniors comprise the fastest growing segment of the country's population. The U.S. Census Bureau predicts that by the year 2050, there will be 86.7 million citizens older than 65. The senior population also is experiencing a growing health care crisis: Alzheimer's disease. This disease, affecting 5.4 million Americans, is touted as one of the most expensive diseases to manage. Those with Alzheimer's disease could require assisted living facilities with specialized memory care or nursing homes. Even seniors without Alzheimer's may need nursing home care. In considering the potential for long-term care, seniors are now growing more concerned with how to pay for that care.

In North Carolina, monthly nursing home costs can conservatively range from $7,000 to $10,000. These costs can quickly impoverish even the most fiscally responsible planners. Further, most seniors prefer to avoid spending their money on long-term care costs. While many seniors will qualify for Medicare health coverage, Medicare does not cover long-term care costs. As a result, many seniors, including mid- to upper-level wealth seniors, are seeking other options like long-term care insurance or Medicaid to pay for nursing home care.

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Medicaid is a government program designed to provide comprehensive medical care to nursing home patients who are generally aged, blind or disabled. Medicaid benefits are only available to medically eligible applicants with limited income and resources. When a Medicaid applicant has assets that exceed what is allowed by Medicaid rules ("countable resources"), those resources must be spent or transferred to qualify for Medicaid. Compensated transfers contemplate an exchange of assets for fair market value. If countable resources are transferred for less than fair market value, an applicant could be penalized if the transfer occurred within the five years prior to a Medicaid application. This five-year "look back" period defines whether an uncompensated transfer will be penalized. The penalty equates to a number of months that an otherwise eligible Medicaid applicant will have to wait before Medicaid covers the costs of long-term care. Essentially, a penalized applicant may have to pay privately for nursing home care beyond the five-year "look back" and through the penalty period.

Medicaid eligibility rules vary by state, subject to federal guidelines. These rules can be complicated. Seniors often work with elder law attorneys to form estate plans that will meet three precepts: (1) protect financial assets for a spouse or loved one, (2) plan for future long-term care costs, and (3) comply with Medicaid's complex rules. Through the use of Medicaid qualified annuities, irrevocable trusts, advanced preplanning and the other tools outlined below, elder law attorneys can help seniors achieve all three goals.

IRREVOCABLE TRUSTS

When seniors have time to plan in advance, irrevocable trusts are powerful tools in planning for long-term care.

Irrevocable trusts are generally drafted, so that they cannot be amended or revoked. Upon creation of an irrevocable trust, the grantor — the person who funds the trust — transfers assets into the trust and names a trustee to administer the trust. To comply with Medicaid rules, the grantor generally does not serve as trustee of an irrevocable trust. The assets are then retitled in the name of the trust and no longer belong to the grantor. Similarly, the assets in an irrevocable trust are intended to avoid being considered as countable resources.

Generally the transfer of assets to trust is an uncompensated transfer without an exchange for fair market value. If the transfer occurs within the five-year "look back" period, the transfer could be penalized. However, if the assets are transferred outside of the five-year "look back" period, no penalty will apply.

With irrevocable trusts, the grantor may elect to receive a stream of income or dividends generated by the trust assets. However, with a properly drafted irrevocable trust, the grantor cannot directly receive any principal from the trust. If the principal were directly accessible to the grantor, then the grantor would run afoul of Medicaid's rules for countable resources. Instead, the grantor names other people as lifetime beneficiaries of the trust principal. In this way, the trust principal can be preserved for future generations while still providing a regular stream of income to the grantor and also allowing the grantor to eventually qualify for public benefits.

An important aspect of irrevocable trusts is that the grantor can retain the power to fire the trustee. If the grantor needs money to pay for nursing home care within the five-year "look back" period, the grantor can then ask the trustee to pay for nursing home costs. If the trustee refuses, the grantor may fire the trustee.

While irrevocable trusts can be costly, these trusts provide more protection to assets than an outright gift. Additionally, there may be tax benefits to using an irrevocable trust.

LONG-TERM CARE INSURANCE

Another effective tool for preplanning for long-term care costs is long-term care insurance. This kind of insurance policy will cover long-term care costs up to a certain amount or through a certain time period. Ideally, when used in conjunction with an irrevocable trust, a long-term care policy would cover all or a portion of long-term care costs during the five-year "look back" period.

Traditional long-term care policies can be renewable, but the rates are not guaranteed. The cost of these policies is based on the age and health of an applicant. Unfortunately, the costs can increase and become cost-prohibitive over time. Hybrid long-term care policies are combined with life insurance or annuities. The advantages of a hybrid policy include guaranteed premiums.

While long-term care insurance has declined in popularity among seniors due to higher costs, these policies offer seniors more time to arrange their estate and protect their assets.

ANNUITIES

In some cases, annuities can protect seniors' assets from going entirely to long-term care costs. To be Medicaid compliant, annuities must meet a number of strict requirements or risk being penalized.

In certain circumstances, married seniors can purchase annuities to protect a significant portion of their assets when one spouse requires nursing home care. Under these circumstances, an annuity is purchased with assets that would normally be considered as countable resources. The annuity then creates a stream of income for the spouse who remains at home. Because transfers between spouses are not penalized, this transfer to an annuity during the five-year "look back" period creates no penalty.

Annuities may not be beneficial for all circumstances, but annuities can be used in preplanning for long-term care and for crisis planning.

USE OF IRAS

In certain circumstances, seniors can use IRAs in conjunction with other tools to further their long-term care planning goals. Where most IRAs can be withdrawn in a lump sum, those accounts could be considered countable resources. Unfortunately, cashing out IRAs may pose severe tax consequences.

One technique is to convert an IRA into an annuity to indirectly purchase a long-term care insurance. Certain allowances are made for use of IRA savings to pay for medical expenses that exceed 10% of the adjusted gross income or to purchase medical insurance. Seniors will first purchase a life insurance plan with a long-term care policy rider. Seniors then use IRA funds to invest in a tax-qualified annuity that makes internal distributions to the insurance carrier. The seniors can indirectly pay for long-term care insurance coverage with IRA money without incurring additional penalties. A variation of this same concept is to make a tax-free transfer of IRA funds into a qualified health savings account that includes long-term care.

Another technique is to transfer a home into an irrevocable trust. If the home still has a mortgage, seniors can use their IRA required minimum distributions to pay mortgage payments on the home, now characterized as "rent" to the trust for use of the home. Or those distributions can be used to purchase a smaller, more manageable home that would be exempt under Medicaid's rules.

Planning for long-term care costs is a complex process for seniors and their families. The amounts protected by these strategies will vary depending on each senior's needs. With advanced planning and careful guidance, seniors can learn which strategies are appropriate for their long-term care goals and unique circumstances.

KARA GANSMANN is an Elder Law attorney in the Wilmington office of Cranfill Sumner & Hartzog LLP. She works with seniors and elders to provide pragmatic solutions to their legal needs. She is a member of the North Carolina Bar Association Elder Law and Special Needs Section and serves as co-chair of the CLE Committee for that section. She also serves as a liaison between the North Carolina Bar Association Elder Law and Special Needs Section and the North Carolina Bar Association Estate Planning and Fiduciary Law Section. Please visit www.elderlawattorneync.com or www.cshlaw.com to learn more about Gansmann and her practice.