Can Life Insurance Affect Your Medicaid Eligibility?

In order to qualify for Medicaid, you can't have more than $2,000 in assets (in most states). Many people forget about life insurance when calculating their assets, but depending on the type of life insurance and the value of the policy, it can count as an asset.

Life insurance policies are usually either "term" life insurance or "whole" life insurance. If a Medicaid applicant has term life insurance, it doesn't count as an asset and won't affect Medicaid eligibility because this form of life insurance does not have an accumulated cash value. On the other hand, whole life insurance accumulates a cash value that the owner can access, so it can be counted as an asset.

That said, Medicaid law exempts small whole life insurance policies from the calculation of assets. If the policy's face value is less than $1,500, then it won't count as an asset for Medicaid eligibility purposes. However, if the policy's face value is more than $1,500, the cash surrender value becomes an available asset.

For example, suppose a Medicaid applicant has a whole life insurance policy with a $1,500 death benefit and a $700 cash surrender value (the amount you would get if you cash in the policy before death). The policy is exempt and won't be used to determine the applicant's eligibility for Medicaid. However, if the death benefit is $1,750 and the cash value is $700. The cash surrender value will be counted toward the $2,000 asset limit.

If you have a life insurance policy that may disqualify you from Medicaid, you have a few options:

- Surrender the policy and spend down the cash value.

- Transfer ownership of the policy to your spouse or to a special needs trust. If you transfer the policy to your spouse, the cash value would then be part of the spouse's community resource allowance.
- Transfer ownership of the policy to a funeral home. The policy can be used to pay for your funeral expenses, which is an exempt asset.
- Take out a loan on the cash value. This reduces the cash value and the death benefit, but keeps the policy in place.

Before taking any actions with a life insurance policy, you should talk to your attorney to find out what is the best strategy for you.

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Do You Pay Capital Gains Taxes on Property You Inherit?

Nope. When you inherit property, such as a house or stocks, the property is usually worth more than it was when the original owner purchased it. If you were to sell the property, there could be huge capital gains taxes. Fortunately, when you inherit property, the property's tax basis is "stepped up," which means the basis would be the current value of the property.

For example, suppose you inherit a house that was purchased years ago for $150,000 and it is now worth $350,000. You will receive a step up from the original cost basis from $150,000 to $350,000. If you sell the property right away, you will not owe any capital gains taxes. If you hold on to the property and sell it for $400,000 in a few years, you will owe capital gains on $50,000 (the difference between the sale value and the stepped-up basis).

On the other hand, if you were given the same property, as opposed to receiving it upon the owner's death, the tax basis would be $150,000. If you sold the house, you would have to pay capital gains taxes on the difference between $150,000 and the selling price. The only way to avoid the taxes is for you to live in the house for at least two years before selling it. In that case, you can exclude up to $250,000 ($500,000 for a couple) of your capital gains from taxes.

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Estate Planning in the Age of Stepfamilies

More than 4 in 10 Americans have at least one step-relative in their family – either a stepparent, a step or half sibling or a stepchild – according to the Pew Research Center. The National Center for Family and Marriage Research estimates that about one-third of all weddings in America create stepfamilies.

A recent trust case from North Dakota highlights the importance of taking current and potential step-relationships into account when planning your estate. William and Patricia Clairmont created two trusts for their grandson, Matthew. In both trusts, "the brother and sisters" of Matthew were contingent beneficiaries (meaning they would be the trust beneficiaries if Matthew died).

After the trusts were created, the Clairmonts' daughter, Cindy (Matthew's mother), divorced Matthew's father, Greg, and Greg remarried and had two children with a second wife. In March 2011, Matthew died suddenly and unexpectedly at the age of 25 without a wife, children or a will.

Under North Dakota law, Greg's two children with his second wife were technically "brothers and sisters" of Matthew and, thus, eligible beneficiaries under the trusts. The Clairmonts argued for an interpretation of the trust that would exclude Matthew's stepsiblings as beneficiaries or, alternatively, for reformation of the trust to include language that only lineal descendants of the Clairmonts could benefit from the trusts.

Ultimately, the North Dakota Supreme Court granted the Clairmonts' petition to reform the trusts based on evidence that the Clairmonts made a mistake of law by interpreting the phrase "brothers and sisters" to include only full blood siblings and based on testimony by the Clairmonts themselves on their intention to benefit their lineal descendants alone.

Although things turned out well for the Clairmonts in the end, it took much time and money to get there. The case stresses the importance of addressing step-relations in your estate plan whether or not you are already a member of a stepfamily.

To read the May 28, 2013 decision, *In re Matthew Larson Trust Agreement*, click here.

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Have You Planned for State Estate and Inheritance Taxes?

Although most people's estates aren't large enough to be affected by the federal estate tax, residents in many state have to consider how state taxes may reduce their estates. Several states have their own estate tax, which can affect much smaller estates than the federal estate tax does. In addition, some states impose an inheritance tax on beneficiaries of an estate.

The federal estate tax exemption is currently $5.25 million for an individual, so most estates are exempt. However, 15 states (Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Tennessee, Vermont, and Washington) and the District of Columbia currently have separate state estate taxes, and six states have an inheritance tax (Iowa, Kentucky, Maryland, Nebraska, New Jersey, and Pennsylvania). The numbers change constantly. In recent years, the trend has been for states to eliminate such taxes. For example, Tennessee is currently phasing out its estate tax, which is set to end in 2016.

If you live in one of the states with an estate tax, you need to take the tax into account when planning your estate. While some states (e.g., Delaware and Hawaii) exempt the same amount

as federal law, other states' estate taxes can affect much smaller estates. For example, New Jersey taxes estates worth more than $675,000 and Oregon taxes estates of more than $1 million. Most states with an estate tax exempt the first $1 million to $2 million of an estate's value. To find out whether your state has an estate tax and how much it is, click here.

Another state tax to take into account when planning your estate is the inheritance tax. An inheritance tax is a tax on the person receiving an inheritance. Spouses are usually exempt from the tax, and in some states, children are as well. Charitable beneficiaries may also be exempt. Usually, the less closely related the beneficiary, the higher the tax. Even if the beneficiary doesn't live in a state with an inheritance tax, if the person who died resided in an inheritance tax state, the beneficiary can still be taxed. For more information about inheritance taxes, click here.

You have several options for avoiding state estate and inheritance taxes, including creating a trust or gifting money. Talk to your attorney to find out the best solution for you. Because the law is constantly changing, even if you have an estate plan, you should check with your attorney to ensure your plan does not need updating.

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Should You Prepare a Medicaid Application Yourself?

Whether you should prepare and file a Medicaid application by yourself or should hire help depends on answers to the following questions:

- How old is the applicant?
- How complicated is the applicant's financial situation?
- Is the individual applying for community or nursing home benefits?
- How much time do you have available?
- How organized are you?

Medicaid is the health care program for individuals who do not have another form of insurance or whose insurance does not cover what they need, such as long-term care. Many people rely on Medicaid for assistance in paying for care at home or in nursing homes.

For people under age 65 and not in need of long-term care, eligibility is based largely on income and the application process is not very complicated. Most people can apply on their own without assistance.

Matters get a bit more complicated for applicants age 65 and above and especially for those of any age who need nursing home or other long-term care coverage. In these cases, availing yourself of the services of an attorney is practically essential.

Medicaid applicants over age 65 are limited to $2,000 in countable assets (in most states). It's possible to transfer assets over this amount in order to become eligible, but seniors need to be careful in doing so because they may need the funds in the future and if they move to a nursing home, the transfer could make them ineligible for benefits for five

years. Professional advice is also crucial because there is a confusing array of different Medicaid programs that may be of assistance in providing home care, each with its own rules.

All of that said, the application process itself is not so complicated for community benefits (care that takes place outside of an institutional setting, such as in the beneficiary's home). In short, those over 65 in many cases will need to consult with an elder law attorney for planning purposes, but they or their families may be able to prepare and submit the Medicaid application themselves.

But submitting an application for nursing home benefits without an attorney's help is not a good idea. This is because Medicaid officials subject such applications to enhanced scrutiny, requiring up to five years of financial records and documentation of every fact. Any unexplained expense may be treated as a disqualifying transfer of assets, and many planning steps – such as trusts, transfers to family members, and family care agreements – are viewed as suspect unless properly explained. Finally, the process generally takes several months as Medicaid keeps asking questions and demanding further documentation for the answers provided.

Many elder law attorneys offer assistance with Medicaid applications as part of their services. This has several advantages, including expert advice on how best to qualify for benefits as early as possible, experience in dealing with the more difficult eligibility questions that often arise, and a high level of service through a long, grueling process. The one drawback of using an attorney rather than a lay service is that the fee is typically substantially higher. However, given the high cost of nursing homes, if the law firm's assistance can accelerate eligibility by even one month that will generally cover the fee. In addition, the payments to the attorney are generally with funds that would otherwise be paid to the nursing home – in other words, the funds will have to be spent in any event, whether for nursing home or for legal

fees.

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