How to Protect an IRA From Heirs’ Creditors

When a person declares bankruptcy, an individual retirement account (IRA) is one of the assets that is beyond the reach of creditors, but what about an IRA that has been inherited? Resolving a conflict between lower courts, the U.S. Supreme Court recently (and unanimously) ruled that funds held in an inherited IRA are *not* exempt from creditors in a bankruptcy proceeding because they are not really retirement funds. *Clark v. Rameker* (U.S., No. 13-299, June 13, 2014).

This ruling has significant estate planning implications for those who intend to leave their IRAs to their children. If the child inherits the IRA and then declares bankruptcy sometime in the future, as a result of the Supreme Court ruling the child’s creditors could take the IRA funds.

Fortunately, there is a way to still protect the IRA funds from a child’s potential creditors. The way to do this is to leave the IRA not to the child but to a “spendthrift” trust for the child, under which an independent trustee makes decisions as to how the trust funds may be spent for the benefit of the beneficiary. However, the trust cannot be a traditional revocable living trust; it must be a properly drafted IRA trust set up by an attorney who is familiar with the issues specific to inherited IRAs.

The impact of the Supreme Court’s ruling may be different in some states, such as Florida, that specifically exempt inherited IRAs from creditor claims. As Florida attorney Joseph S. Karp explains in a recent blog post, Florida’s rule protecting inherited IRAs will bump up against federal bankruptcy law, and no one knows yet which set of rules will prevail. While a debtor who lives in Florida could keep a creditor from attaching her inherited IRA, it is unknown whether that debtor would succeed in having her debts discharged in bankruptcy while still retaining an inherited IRA. We will have to wait for the courts to rule on this issue. In the meantime, no matter what state you are in, the safest course if you want to protect a child's IRA from creditors is to leave it to a properly drafted trust.

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5 Questions To Ask Before Making Gifts for Tax Planning or Medicaid

Many seniors consider transferring assets for estate and long-term care planning purposes, or just to help out children and grandchildren. Gifts and transfers to a trust often make a lot of sense. They can save money in taxes and long-term care expenditures, and they can help out family members in need and serve as expressions of love and caring.

But some gifts can cause problems, for both the generous donor and the recipient. Following are a few questions to ask yourself before writing the check:

1. **Why are you making the gift?** Is it simply an expression of love on a birthday or big event, such as a graduation or wedding? Or is it for tax planning or long-term care planning purposes? If the latter, make sure that there's really a benefit to the transfer. If the value of your assets totals less than the estate tax threshold in your state, your estate will pay no tax in any case. For

federal purposes the threshold is $5.34 million (in 2014). Gifts can also cause up to five years of ineligibility for Medicaid, which you may need to help pay long-term care costs.

2. **Are you keeping enough money?** If you're making small gifts, you might not need to worry about this question. But before making any large gifts, it makes sense to do some budgeting to make sure that you will not run short of funds for your basic needs, activities you enjoy – whether that's traveling, taking courses or going out to eat – and emergencies such as the need for care for yourself or to assist someone in financial trouble.
3. **Is it really a gift (part one)?** Are you expecting the money to be paid back or for the recipient to perform some task for you? In either case, make sure that the beneficiary of your generosity is on the same page as you. The best way to do this is in writing, with a promissory note in the case of a loan or an agreement if you have an expectation that certain tasks will be performed.
4. **Is it really a gift (part two)?** Another way a gift may not really be a gift is if you expect the recipient to hold the funds for you (or for someone else, such as a disabled child) or to let you live in or use a house that you have transferred. These are gifts with strings attached, at least in theory. But if you don't use a trust or, in the case of real estate, a life estate, legally there are no strings attached. Your expectations may not pan out if the recipient doesn't do what you want or runs into circumstances – bankruptcy, a lawsuit, divorce, illness – that no one anticipated. If the idea is to make the gifts with strings attached, it's best to attach those strings legally through a trust or life estate.
5. **Is the gift good for the recipient?** If the recipient has special needs, the funds could make her ineligible for various public benefits, such as Medicaid, Supplemental

Security Income or subsidized housing. If you make many gifts to the same person, you may help create a dependency that interferes with the recipient learning to stand on his own two feet. If the recipient has issues with drugs or alcohol, he may use the gifted funds to further the habit. You may need to permit the individual to hit bottom in order to learn to live on his own (i.e., don’t be an “enabler”).

If after you’ve answered all of these questions, you still want to make a gift, please go ahead. But unless the gift is for a nominal amount, it is advisable to check with your attorney to make sure you are aware of the Medicaid, tax and other possible implications of your generosity.

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Medicaid Expansion Signups Hindered by Fear of Estate Recovery

A fear that the government will seize their house after they die is causing some people to not sign up for expanded Medicaid under the Affordable Care Act (ACA). A long-standing provision in Medicaid law allows states to recoup Medicaid costs by putting a claim on the home or other assets of older deceased Medicaid recipients.

In 1993, Congress passed a law requiring that states try to recover from the estates of deceased Medicaid recipients whatever benefits they paid for the recipient's long-term care. But the law allows states to go further and recover all Medicaid benefits from individuals over age 55, including costs for any medical care, not just long-term care benefits.

The ACA gives states the option of expanding Medicaid eligibility to individuals and families with incomes up to 133 percent of the poverty line, and so far 26 states have taken this option. Now that more people are becoming eligible for Medicaid under the ACA, there are potentially more people who may have their houses (or other valuable assets) sold after they die to pay off Medicaid debt. People subject to this estate recovery would have to live in one of the 26 states, and their state would have to be recovering the costs of all Medicaid benefits, not just long-term care. Still, there are protections: the state cannot take a house if there is a surviving spouse, a child under age 21 or a child of any age who is blind or disabled.

According to the *Washington Post*, the realization that their house might be subject to estate recovery is giving some with low incomes second thoughts about signing up for Medicaid, even though not doing so will likely mean going without any insurance at all. ACA plans bought in the regular marketplace are not subject to estate recovery, but individuals who qualify for expanded Medicaid coverage are not able to get a subsidy to buy coverage in the marketplace. If someone doesn't want to be subject to estate recovery, there are two options: buy a plan from the marketplace without a subsidy, or buy no insurance at all.

In order to encourage people to sign up for Medicaid, both Oregon and Washington have changed their rules to allow estate recovery only for long-term care debt. In addition, advocates are asking the federal government for clarification on whether Medicaid estate recovery will apply to people who purchase expanded Medicaid coverage. A spokesman for the Centers for

Medicare and Medicaid Services told the *Post*, “We recognize [the] importance of this issue and will provide states with additional guidance in this area soon.”

For the *Washington Post* article, click here.

For more on Medicaid’s estate recovery rules, click here

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Using an Annuity to Keep the Spouse of a Medicaid Applicant from Becoming Impoverished

When one spouse qualifies for Medicaid to pay for a nursing home stay, the spouse who is at home is often left without many resources. While Medicaid has rules to prevent community spouses from impoverishment, the protections aren’t always enough. There are steps that you can take to increase the community spouse’s income, and as a recent case illustrates, an annuity may be a good option.

In order to qualify for Medicaid coverage, the applicant can have no more than $2,000 in resources (in most states). In general, the community spouse may keep one-half of the couple’s total “countable” assets up to a maximum of $115,920 (in 2013). Called the “community spouse resource allowance,” this is the most that a state may allow a community spouse to retain without a hearing or a court order. The least that a state may allow a community spouse to retain is $23,184 (in 2013).

One way to ensure that the community spouse has enough money to live on is for the community spouse to purchase an annuity. By purchasing an annuity, the spouse turns a countable resource into an income stream, which should not be counted by Medicaid. The annuity must meet certain qualifications in order to not be considered an asset transfer, including be irrevocable and name the state as a remainder beneficiary. (For more information on annuities and Medicaid planning, click here.)

Some states have improperly denied Medicaid benefits to an applicant whose spouse has purchased an annuity, but a recent decision by a U.S. Court of Appeals makes clear that community spouses can purchase annuities under current federal law.

North Dakota resident John Geston entered a nursing home, and his wife purchased a single-premium annuity for $400,000, which would give her $2,735 a month in income over 13 years. The annuity provided that it could not be sold or transferred, and it named the state as a remainder beneficiary. Mr. Geston applied for Medicaid benefits, but the state denied him benefits on the grounds that the annuity was an available asset under state law. Mr. Geston sued in federal court, challenging the state law. In *Geston v. Anderson* (8th Cir., No. 12-2224, Sept. 10, 2013), the 8th Circuit Court of Appeals decided in favor of the Gestons, ruling that the annuity was not a resource and should not be counted in determining Mr. Geston's eligibility for Medicaid. To read the full case, click here.

Before purchasing an annuity or applying for Medicaid, you should consult with your attorney who can tell you the best way to protect your spouse.

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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