Estate Planning with Medicaid: Qualification and Planning for the Elderly

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I. INTRODUCTION

Financing the catastrophic costs of long-term care is of grave importance to elderly individuals.\(^1\) With nursing-home costs ranging from thirty-thousand to more

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than fifty-thousand dollars annually, an elderly individual can exhaust his or her lifetime savings in a matter of months paying for long-term care. Although public assistance is available to help low-income individuals finance long-term care, the eligibility criteria mandate legal poverty before assistance is available. According to the U.S. Department of Health and Human Services, approximately one-half of Medicaid recipients became eligible for benefits only after becoming impoverished in an attempt to finance nursing-home care.

Middle-class individuals in need of long-term care must dispose of their assets exceeding poverty limits either to pay for their care or, in the alternative, to qualify for public assistance. Thus, unlike the affluent (who can provide for their own health-care needs) and low-income individuals (who qualify for public assistance), middle-class individuals must forfeit any wealth accumulated through a lifetime of hard work and savings to pay for long-term care. This forfeiture is a harsh result for an individual who has saved for a lifetime to provide for the future and who has paid taxes to support government programs like Medicaid.

Other than long-term care insurance, the alternative to personally financing nursing-home care is the federal Medicaid program. Codified as title XIX of the Social Security Act, Medicaid is a joint federal-state program that provides medical assistance to eligible individuals. Medicaid also pays for long-term care in a

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2 Budish, supra note 1, at 48.

3 See infra part II.


6 See infra notes 7-10 and accompanying text; Dwight F. Bickel, Medicaid Eligibility Planning after the 1993 OBRA Amendments, PRAC. LAW., Jan. 1994, at 23.

7 Note that “[a]pproximately 80-85% of elderly Americans find private insurance for nursing home care prohibitively expensive.” McEwen & Harl, supra note 1, at 1379 n.3.

nursing home. In fact, Medicaid pays about forty percent of our nation’s nursing-home costs.

This Note will serve seven purposes. First, it will discuss the qualification criteria for Medicaid entitlement. Second, it examines, specifically, the asset qualification criteria, including limitations on the quantity and quality of assets an applicant may possess, recovery of medical assistance by states from the estate of a deceased recipient, and restrictions on asset divestment. Third, it discusses a planning technique that will reduce or eliminate the value of an applicant’s assets for eligibility purposes and will secure favorable tax treatment on the transferred property. Fourth, it discusses Medicaid eligibility in West Virginia. Fifth, it examines the tax implications of the planning technique discussed above. Sixth, it confronts the ethical considerations evident in disposing of assets in order to qualify for public assistance. Finally, this Note urges estate planners to derive a thorough knowledge of the Medicaid regulations to advise their clients on how to qualify for Medicaid.

II. SCOPE AND INTRODUCTION TO MEDICAID ELIGIBILITY

States may participate in the Medicaid program on a voluntary basis, but participating states must administer their programs pursuant to federal guidelines. States follow one of two models to establish Medicaid eligibility criteria; they are either “SSI states” or “section 209(b) states.” SSI states use the eligibility criteria for federal Supplemental Security Income (SSI). Section 209(b) states may use more restrictive criteria for Medicaid entitlement than the federal SSI standards, but no more restrictive than the criteria used to determine Medicaid eligibility as they existed in 1972. Because only thirteen states are section 209(b) states, and because

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9 See BUDISH, supra note 4, at 13.
10 Id.
11 McEowen & Hart, supra note 1, at 1381.
12 See REGAN, supra note 8, at 59.
13 See id.
14 Id. “In 1972, Congress restructured the Social Security program and replaced three of the four welfare assistance programs with Supplemental Security Income (SSI) for the aged, blind, and disabled.” Roger A. McEowen, Estate Planning for Farm and Ranch Families Facing Long-Term Health Care, 73 Neb. L. Rev. 104, 107-08 (1994) (citing 42 U.S.C. §§ 1381-1391 (1994)). Because this restructuring increased the number of eligible recipients by broadening the income eligibility requirements, in 1974 Congress offered participating states the option to retain their
West Virginia is an SSI state, this Note will focus on the Medicaid eligibility criteria in SSI states.\(^5\)

In order to qualify for Medicaid entitlement, an applicant must satisfy the following criteria: (1) the applicant must be within a category of eligible recipients (the categorically needy test);\(^6\) (2) the applicant’s income must fall below the state limit (the income test);\(^7\) and (3) the applicant’s assets must fall below the state limit (the asset test).\(^8\)

Federal SSI Regulations (the Regulations) require coverage of “categorically needy” individuals.\(^9\) An applicant who is eligible for assistance under SSI or under a state’s Assistance for Families with Dependent Children program is categorically needy.\(^10\) An applicant must also be financially needy; that is, the individual’s countable income and assets\(^22\) must fall below the state limits.\(^23\) Medicaid entitlement is not available when the applicant has available resources to pay for long-term care.\(^24\) States determine the availability of an applicant’s resources by setting limits on income and assets, above which the applicant will have to spend down to qualify for Medicaid entitlement.\(^25\) Thus, the Medicaid eligibility criteria in effect on January 1, 1972; this election became known as the “section 209(b) option.”\(^\) Id. at 108.


\(^6\) REGAN, supra note 8, at 59. These persons generally include the aged, blind and disabled. Id.

\(^7\) See McEown & Harl, supra note 1, at 1384.

\(^8\) See id. at 1403.


\(^21\) Only income received in cash or in kind that can be used to meet needs for food, clothing, or shelter is income for Medicaid purposes. 20 C.F.R. § 416.1102 (1996).

\(^22\) See infra part III.A.

\(^16\) REGAN, supra note 8, at 59.

\(^23\) REGAN, supra note 8, at 60.

\(^24\) See BUDISH, supra note 4, at 13.

\(^25\) McEown & Harl, supra note 1, at 1403. However, each state’s limits may be no more stringent than what the federal law allows. See id. at 1383.
program is essentially a welfare program;\textsuperscript{26} the most fundamental inquiry is the presence of legal poverty and not illness.\textsuperscript{27}

In addition, states may extend benefits to "medically needy" individuals, whose resources exceed the limit imposed for categorically needy status but are insufficient to finance the costs of medical care.\textsuperscript{28} Because coverage of medically needy individuals is permissive and not provided by all states, this Note will focus on the eligibility criteria for categorically needy individuals. Specifically, this Note will focus on the financial criteria which limit the value of assets an applicant may possess and still qualify for Medicaid.

III. ASSET TEST

A. \textit{Assets Included in the Medicaid Estate}\textsuperscript{29}

An applicant's Medicaid estate includes all his or her nonexempt assets or, if married, those nonexempt assets owned by both spouses, jointly or separately, on either the date the spouse is admitted to an institution or applies for Medicaid.\textsuperscript{30} For married individuals, the total fair market value of these assets is considered available to the institutionalized spouse.\textsuperscript{31} However, an exception to this rule permits the community spouse to retain a spousal allowance equivalent to one-half of the combined, nonexempt assets without any obligation to spend it on behalf of the institutionalized spouse.\textsuperscript{32} Accordingly, the Medicaid estate includes the

\textsuperscript{26} Bickel, \textit{supra} note 6, at 22-23.

\textsuperscript{27} \textit{Id}.


\textsuperscript{29} The term "Medicaid estate" denotes an inventory of those assets in which the applicant has an ownership interest.

\textsuperscript{30} REGAN, \textit{supra} note 8, at 65 (citing 42 U.S.C. § 1396r-5(c)(1) (1994)).

\textsuperscript{31} McEowen & Harl, \textit{supra} note 1, at 1404.

\textsuperscript{32} \textit{Id}. The spousal share in West Virginia must be at least $15,804 and not more than $79,020 (1997 figures). Assets, W.Va. Income Maintenance Manual (W.Va. Dep't of Health and Human Resources) § 17.10 (Jan. 1997). States may set a higher minimum within this range for the spousal share. REGAN, \textit{supra} note 8, at 66. If the share is less than the state's minimum, then that portion of the institutionalized spouse's resources necessary to reduce the deficiency will be transferred to the community spouse. \textit{Id}. 
institutionalized spouse’s nonexempt assets above the asset limit and the community spouse’s nonexempt assets above the spousal share.  

In general, almost all money and property owned by the applicant is included in his or her Medicaid estate.  Specifically, the Regulations define an applicant’s resources as “cash or other liquid assets or any real or personal property that an individual (or spouse, if any) owns and could convert to cash to be used for his or her support and maintenance.” The Regulations further distinguish resources between liquid and nonliquid, providing that liquid resources include “cash or other property which can be converted to cash within 20 days” and nonliquid resources include “property which is not cash and which cannot be converted to cash within 20 days.” In addition, nonliquid resources are valued according to the price at which they can reasonably be expected to sell for less encumbrances (equity value). The applicant must reduce these assets to the applicable state limit before financial assistance is available.

Exempt assets are excluded from the Medicaid estate for eligibility purposes. They include the home, household goods and personal effects up to

The range for the spousal allowance is twelve thousand to sixty thousand dollars. 42 U.S.C. § 1396r-5(f)(2)(A) (1994). These figures are adjusted per increases in the consumer price index for all urban consumers between September 1988 and the September before the calendar year involved. 42 U.S.C. § 1396r-5(g) (1994).

33 McEown & Harl, supra note 1, at 1404.
34 BUDISH, supra note 4, at 17.
36 20 C.F.R. § 416.1201(b) (1996) (including "stocks, bonds, mutual fund shares, promissory notes, mortgages, life insurance policies, [and] financial institution accounts."). “Liquid resources, other than cash, are evaluated according to the individual’s equity in the resources.” Id.
37 20 C.F.R. § 416.1201(c) (1996) (including “loan agreements, household goods, automobiles, trucks, tractors, boats, machinery, livestock, buildings and land.").
38 Id.
39 See REGAN, supra note 8, at 60.
40 BUDISH, supra note 4, at 18-20; see GORDON, supra note 5, at 47-49.
41 20 C.F.R. § 416.1210(a) (1996). “The home is any property in which an individual (and spouse, if any) has an ownership interest and which serves as the individual’s principal place of residence.” 20 C.F.R. § 416.1212(a) (1996).
$2,000; 42 one automobile with a $4,500 or less market value; 43 equity in property used in a trade or business for self-support; 44 equity in non-business property used for self-support up to $6,000; 45 life insurance with a cash surrender value up to $1,500; 46 burial spaces and up to $1,500 for certain burial expenses; 47 and federal income tax refunds. 48 However, as discussed immediately below, estate recovery renders this exclusion short-lived.

B. Estate Recovery

Although exempt assets are excluded from the Medicaid estate for eligibility purposes, states must recoup their financial assistance by recovering its value from the estate of a deceased Medicaid recipient. 49 States shall recover the costs of Medicaid benefits from the estates of deceased recipients who were fifty-five years old or more when they received Medicaid and who received nursing-home care, home and community-based care, and related hospital and prescription drug services. 50 Estate recovery applies to Medicaid benefits received on or after October 1, 1993. 51

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43 20 C.F.R. § 416.1210(c) (1996). If the value of the automobile exceeds $4,500, then such excess is counted against the resource limit. 20 C.F.R. § 416.1218(b)(2) (1996).

However, the exclusion is unlimited if the individual or a member of his or her household uses the automobile as a means of traveling to work or to medical services; if the automobile has been modified for operation by or transportation of a handicapped person; or if the automobile is needed, because of climate, terrain, distance, or other similar reason, to perform essential daily activities. 20 C.F.R. § 416.1218(b)(1) (1996).


45 20 C.F.R. § 416.1210(e) (1996). Income-producing property must produce a net annual income to the applicant of at least 6% of the excluded equity. 20 C.F.R. § 416.1222(a) (1996).


For estate recovery purposes, the deceased recipient’s estate includes all of the individual’s probate estate. At the state’s option, the estate may also include:

any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including such assets conveyed to a survivor, heir, or assign of the deceased individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement.

Additionally, states may impose a lien on a Medicaid recipient’s real property who is deemed permanently institutionalized. However, no lien shall be imposed on the individual’s home if it is the lawful residence of the recipient’s spouse, minor or disabled child, or sibling who has an equity interest in the home and who has resided in the home for at least one year prior to the individual’s admission to a medical institution.

C. The Ineligibility Period

In addition to the limits imposed by estate recovery on a Medicaid applicant’s ability to control the disposition of his or her assets, the Regulations impose an ineligibility period for certain assets transferred for less than fair market value prior to application for Medicaid. The ineligibility period will equal the uncompensated value of the transferred asset (the excess of the asset’s fair market value over the sales price) divided by the average monthly cost of nursing-home care in the state of application.

Even so, the Regulations provide a grace period, during which asset transfers for less than fair market value will not invoke an ineligibility period.
order to compute an ineligibility period for transfers made after August 11, 1993, only those assets transferred within the previous thirty-six months of either application for Medicaid or institutionalization are considered. Accordingly, assets transferred for less than fair market value before the look-back period will not invoke an ineligibility period.

Whether the applicant is institutionalized on the date of application determines the start of the look-back period. For institutionalized individuals, the look-back period begins on the date on which the applicant is both institutionalized and has applied for Medicaid. For non-institutionalized individuals, the look-back period begins on the latter of the date on which the individual either applies for Medicaid or disposes of property for less than fair market value.

IV. TRANSFER PLANNING TECHNIQUE

For Medicaid eligibility purposes, the goal is to reduce the value of nonexempt assets in the applicant’s Medicaid estate below the specified limits. Asset protection planning may involve various methods to reduce the value of assets held in an applicant’s name. These methods include “the transfer of assets, creation of certain trusts, conversion of excess resources to exempt assets, and outright gifts.” This Note will discuss the effectiveness for Medicaid qualification purposes of transferring property and retaining a life estate.

59 Id. The Medicare Catastrophic Coverage Act of 1988 governs transfers made before August 11, 1993 and provides a look-back period equal to 30 months. REGAN, supra note 8, at 68-69.

60 In addition to an ineligibility period, the Health Insurance Portability and Accountability Act of 1996, which was signed by President Clinton in August of 1996, makes it a federal crime to knowingly and willfully dispose assets in order to become eligible for Medicaid if the disposition results in an ineligibility period. Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 217, 1996 U.S.C.C.A.N. (110 Stat. 1936) 1865, 2064-65 (to be codified at 42 U.S.C. §§ 1320a-7b(a)(6)).


64 Asset Protection, supra note 5, ¶ 11.05[1].

65 Id.
A. Transfer Property and Retain a Life Estate

Transferring property while retaining a life estate will minimize or eliminate the value of nonexempt assets and will secure favorable tax treatment on the transferred property. Assuming the transfer occurs before the look-back period, the state will, at most, include only the value of the life estate in the applicant’s Medicaid estate. Some states conclude that a life estate has no value because nobody would purchase it. Therefore, because the value of a life estate is less than the value of a full ownership interest, and because some states deem a life estate to have no value, outright transfers retaining a life estate enable a Medicaid applicant to reduce the value of that asset in his or her Medicaid estate or to eliminate that asset’s value altogether.

Regardless, in most states the usefulness of this technique to reduce the asset’s value in the Medicaid estate is thwarted by the method employed to value life estates. Accordingly, one district court recognized the discrepancy between the value of a life estate produced by codified life estate calculations and its value derived from market forces. In Cothran v. Wallace, the District Court for the Middle District of Alabama held that the procedure outlined under Alabama law to value the plaintiff’s life estate violated the requirements of the federal Social Security Act because the defendants’ valuation of the plaintiff’s life estate did not consider its unsaleability on the open market.

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66 Most states use life expectancy tables to value a life estate. In general, the values of life estates held by individuals aged fifty and eighty are calculated by multiplying the market value of the property by .84743 and .43659 respectively. Even the value of a life estate held by an individual aged 100 is deemed to be .19975 of its market value. BUDISH, supra note 4, at 78.

67 Id.

68 Id.

69 Id.

70 Id.


72 Id. The plaintiff in Cothran v. Wallace was eighty years old when he filed suit alleging that the procedure used to value his life estate violated the federal Social Security Act and the Equal Protection and Due Process Clauses of the United States Constitution. The Alabama Medicaid Agency valued the plaintiff’s life estate according to a life estate factor derived from the Life Estate and Remainder Tables found in the Federal Regulations. The plaintiff sought to no avail to sell his life estate. The
A life estate is a nonliquid resource evaluated according to its equity value. In *Cothran*, the court considered the unsaleability of the life estate on the open market in determining its equity value. It also illustrates how unmarketable is a life estate held by an elderly individual and emphasizes the unrealistic result produced by codified valuation procedures.

Even so, most states include the value of a life estate in the Medicaid estate. Consequently, in these states, the utility of an asset transfer retaining a life estate includes reducing, but not eliminating, the value of nonexempt assets in the applicant's Medicaid estate; thereby, decreasing the total value of nonexempt assets the applicant will have to deplete by other means.

B. Potential Problems

Federal criteria permit a broad interpretation of the term “estate” for estate recovery purposes. Although the remainder interest will be protected from estate recovery, it is unclear whether states will seek recovery from a life estate, the value of which could be determined from an actuarial valuation based on the age of the recipient at the time of his or her death.

Notwithstanding estate recovery, this technique may not meet the needs of every client. First, the asset transfer is essentially an outright conveyance subject to the donor’s right to occupy and use the property during his or her lifetime. Even
though the donor does not control the asset, except for the life estate which probably cannot be sold for any real value, most states include at least part of the asset’s value in his or her Medicaid estate. Therefore, the donor must pay an amount equal to the value included in his or her Medicaid estate towards his or her care before he or she can qualify for public assistance.

Additionally, the donee owns a remainder interest in the property which may become vulnerable to lawsuits or to a division of marital property pursuant to divorce.79 Clients must therefore be advised of the permanent impact of asset divestment.80

C. **Fraudulent Transfer Issues**

One should also consider any fraudulent transfer issues affecting asset transfers enabling an individual to qualify for Medicaid.81 Whether an asset transfer made by a Medicaid recipient prior to Medicaid qualification is fraudulent may depend upon whether the state is considered a creditor at the time of transfer.82 Because an individual may or may not need long-term care, the state is only a future possible creditor when the individual makes a gratuitous transfer other than to qualify for Medicaid.83 For these individuals, federal law does not impose an ineligibility period.84 However, for the individual who makes a gratuitous transfer prior to applying for Medicaid and waits through an ineligibility period, the state is a subsequent probable creditor.85

79 GORDON, supra note 5, at 241.

80 See Crosby & Leff, supra note 5, at 1511.

81 See also Asset Protection, supra note 5, ¶ 3.01 (stating that “[i]n connection with virtually every transfer made pursuant to an asset protection plan, counsel must consider the fraudulent transfer laws, namely the Uniform Fraudulent Conveyances Act (UFCA), the Uniform Fraudulent Transfers Act (UFTA), and the applicable Bankruptcy Code provisions.”).

In addition to transfers made with the actual intent to defraud creditors, these statutes sometimes apply even when there is no real fraud, but simply a transfer of assets where the transferor does not receive full value in return, or where the transferor is paying off debts to a relative or a related business. See W. VA. CODE §§ 40-1A-4 to -5 (Supp. 1996).

82 RUTH R. LONGENECKER WITH RICHARD T. TAPS, FINANCIAL AND HEALTH CARE PLANNING FOR THE ELDERLY IN OHIO 167 (1994) [hereinafter LONGENECKER].

83 Id. at 171.


85 LONGENECKER, supra note 82, at 167.
Asset transfers must be made at least thirty-six months prior to Medicaid application to avoid an ineligibility period. This ineligibility period already penalizes the Medicaid recipient for transfers made pursuant to application. States may not impose an ineligibility period in addition to the one provided for by the federal requirements. Therefore, it can be argued that the federally mandated ineligibility period preempts state fraudulent transfer claims. If the transfer is made within the look-back period, then the applicant should disclose the transfer so as to trigger an ineligibility period.

V. MEDICAID IN WEST VIRGINIA

Pursuant to federal guidelines, West Virginia has implemented a state plan to administer Medicaid entitlement which incorporates federal criteria. In general, 

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86 See supra part III.C.


88 LONGENECKER, supra note 82, at 168.

89 Id. at 168-70. Disclosure of asset transfers made by Medicaid recipients prior to application should preclude state fraudulent transfer claims. Id. In addition to the potential double penalization imposed on asset transfers by an ineligibility period and a fraudulent transfer claim, the doctrine of estoppel should bar a state from asserting its fraudulent transfer law. Id. Disclosure informs the state of these transfers; accordingly, the state imposes an ineligibility period, if any, and grants the Medicaid applicant benefits. Id.

For a discussion of whether asset transfers made after Medicaid qualification are fraudulent, see LONGENECKER, supra note 82, at 168-71.

Also, the applicable statute of limitations may prevent a state from asserting a fraudulent transfer claim in the Medicaid context. For instance, the statute of limitations in West Virginia regarding fraudulent transfer claims based on the transferor's actual intent to hinder, delay, or defraud any creditor, is "four years after the transfer was made...or within one year after the transfer...was or could reasonably have been discovered." W.VA. CODE § 40-1A-9(a) (Supp. 1996). A Medicaid applicant in West Virginia avoids a fraudulent transfer claim if he or she transfers assets, at the least, three years prior to application and receives benefits one year after application; accordingly, four years have passed since the transfer was made and one year has passed since the state could have reasonably discovered the transfer when the applicant receives Medicaid benefits.

90 W.VA. CODE STATE R. § 78-10-1 (1996) (effective date Oct. 1, 1985) ("The state plan establishes requirements for the designation, organization, and general administrative activities of a state agency responsible for operating the State Medicaid program and the conditions under which federal funds are available for expenditures related to the provision of Medicaid services."). The West Virginia State Plan for Medicaid is available from the Secretary of State's Office or the West Virginia Department of Human Resources. W.VA. CODE STATE R. § 78-10-2 (1996) (effective date Oct. 1, 1985).

All eligibility requirements have been submitted to and approved by the Health Care
financial eligibility is determined using SSI or Aid to Families with Dependent Children income and resource standards.\textsuperscript{91}

In order to qualify for Medicaid in West Virginia, the value of nonexempt assets may not exceed two thousand dollars.\textsuperscript{92} Accordingly, an applicant must dispose of assets exceeding this limit before the look-back period to avoid an ineligibility period.

Also, the value of a life estate is included in the Medicaid estate in West Virginia. The life estate itself is not considered an asset for Medicaid eligibility purposes, but the value of the life estate is treated as an asset when it is not the applicant's principal place of residence (an exempt asset).\textsuperscript{93} The value of a life estate is derived by multiplying the current market value of the asset by the appropriate life estate factor;\textsuperscript{94} the resulting amount is included in the Medicaid estate.\textsuperscript{95} Although in West Virginia an applicant for Medicaid entitlement cannot exclude the entire value of an asset by transferring it and retaining a life estate, he or she can exclude a portion of its value. The older the applicant when the transfer is made, the greater the exclusion from the Medicaid estate.\textsuperscript{96}

Finally, West Virginia requires estate recovery in order to comport with the federal mandate.\textsuperscript{97} Beginning June 16, 1995,\textsuperscript{98} estate recovery allows the state to file a claim or lien against the estate of Medicaid recipients deemed permanently

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\textsuperscript{91} Frazier Letter, supra note 90.


\textsuperscript{94} Id. at app. A.

\textsuperscript{95} Id. at § 11.4(AA)(4). The applicant may provide proof that the life estate is worth less than the determined value. Id.

\textsuperscript{96} For instance, the percentage of an asset’s value included in the Medicaid estate in West Virginia for an individual aged 40, 50, 60, and 65 is .91571, .84743, .74491, .67970 respectively. Id. at app. A.

\textsuperscript{97} See supra note 49 and accompanying text.

\textsuperscript{98} W. VA. CODE STATE R. § 78-17-1.4 (1996) (effective date June 16, 1995).
institutionalized for the total amount of medical assistance. The deceased recipient’s estate is defined as “[t]he real and personal property belonging to a person or a decedent at the time of his/her death, including any intangible interests therein.”

If the state places a lien against the recipient’s property, then it will seek reimbursement if the property is sold. Even though, the state may not impose a lien when the recipient’s home is the lawful residence of the individual’s spouse, minor or disabled child, or a sibling who has an equity interest in the home and who has resided in the home for at least one year prior to the individual’s admission to a medical institution.

In sum, the utility of transferring assets while retaining a life estate in order to qualify for Medicaid is conditioned on local law for two reasons. First, states may include the value of a life estate in the applicant’s Medicaid estate for eligibility purposes. If a state opts to exclude the life estate’s value, then the asset transfer eliminates its value from the Medicaid estate so long as the asset transfer is made at least thirty-six months prior to Medicaid application. If the state opts to include the life estate’s value, then the effectiveness of the asset transfer is limited to reducing the asset’s value in the Medicaid estate.

Second, states may include the value of a life estate in the deceased recipient’s estate for purposes of estate recovery. Because states may seek reimbursement from assets outside the decedent’s probate estate, namely a life estate, the applicant’s ability to protect the life estate’s value from estate recovery is premised on local law.

Notwithstanding estate recovery, an applicant for Medicaid may eliminate or reduce the value of assets from his or her Medicaid estate by transferring property for less than fair market value and retaining a life estate. Additionally, the asset transfer will yield favorable tax consequences for the donee as discussed below.

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99 W. VA. CODE § 9-5-11c(a) (Supp. 1996) (stating that the “[c]laims so filed shall be classified as and included in the class of debts due the state.”).


101 W. VA. CODE § 9-5-11c(c) (Supp. 1996).


103 Such is the case in West Virginia. See supra note 93 and accompanying text.
VI. TAX CONSEQUENCES

The planning technique discussed in this Note will secure favorable gift, estate, and income tax treatment on the transferred property.

A. Gift and Estate Tax Consequences

Generally, any time an individual transfers wealth (either during life or at death) a transfer tax\(^{104}\) is due.\(^{105}\) However, the code provides a unified credit of $192,800 against the transfer tax liability imposed.\(^{106}\) The value of the credit equals the tax imposed on $600,000 of transferred property.\(^{107}\) Thus, an individual may exclude up to $600,000 of the value of assets transferred during life and/or at death from estate and gift tax liability.\(^{108}\)

Further, the value of the transferred property subject to the gift tax can be reduced. The reservation of a life estate reduces the value of the gifted asset to the transferee.\(^{109}\) Only the value of the remainder interest is subject to gift tax liability.\(^{110}\) Because the value of the transferred asset is reduced by retaining a life estate, the transferor preserves his or her unified credit.\(^{111}\)

B. Income Tax Consequences on a Subsequent Sale

The gain on the sale of property equals the amount realized on the sale

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\(^{104}\) The term “transfer tax” includes the estate tax imposed by § 2001 and the gift tax imposed by § 2501.


\(^{108}\) I.R.C. § 2010(a); I.R.C. § 2505(a). The first ten thousand dollars of gifts made by a donor during a taxable year are excluded from the gift tax. I.R.C. § 2503(b) (1994).


\(^{110}\) See id. Note that the ten thousand dollars exclusion from gift tax liability does not apply to transfers of future interests. I.R.C. § 2503(b) (excluding gifts of future interests from subsection).

\(^{111}\) See Coffey, supra note 109, at 14.
(usually the sales price) less the adjusted basis of the property. Because gains derived from the sale of property are subject to income tax, the goal is to achieve the highest possible basis in order to minimize the gain on a subsequent sale.

Various sections determine the basis of property for income tax purposes, depending upon the manner of its acquisition. Section 1015 provides that property acquired by gift shall have a carryover basis equal to the donor’s basis. Thus, any gain realized on a subsequent sale will include that amount of appreciation, if any, attributable to the time which the donor held the property. Section 1014 provides that property acquired from a decedent shall have a basis equal to the property’s fair market value on the date of the decedent’s death. Accordingly, a basis computed under section 1014 will minimize the gain derived from a subsequent sale of property by stepping up the basis to include that amount of appreciation attributable to the decedent’s ownership of the property.

Section 1014, not section 1015, will govern the basis determination when a donor transfers property and retains a life estate. To qualify for basis treatment under section 1014, “property must meet the definition of at least one of the 9 categories of subsection (b).” The remainder interest acquired by the donee from the asset transfer discussed in this Note qualifies for section 1014 treatment, because it is “[p]roperty acquired by . . . the decedent’s estate from the decedent,” one of the nine statutory classifications for section 1014 treatment. The remainder interest meets the aforementioned statutory classification because, for federal estate tax purposes, the property is derived from the transferor’s estate pursuant to section 2036.

Section 2036 provides that “[t]he value of the gross estate shall include the

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114 All references to “section” are to sections of the Internal Revenue Code of 1986, as amended.
120 I.R.C. § 2036(a) (1994); see GORDON, supra note 5, at 240.
value of all property to the extent of any interest therein of which the decedent has at any time made a transfer... under which he has retained for his life... the possession or enjoyment of... the property." \(^{121}\) Because the transferor reserves a life estate in the transferred property, that retained interest is enough to invoke inclusion of the entire property in the decedent's estate. \(^{122}\) Consequently, although the value of the remainder and maybe the asset's entire value is excluded from the Medicaid estate, \(^{123}\) the value of the entire property transferred is included in the decedent's gross estate for estate tax purposes, (life estate and remainder interest). \(^{124}\)

In sum, inclusion of the transferred property in the decedent's estate for estate tax purposes, pursuant to section 2036, gives the donee a stepped-up basis equal to the fair market value of the property on the date of the decedent's death. Moreover, this inclusion does not invoke any estate tax liability if the decedent's total transfers (inter vivos and testamentary) are less than six hundred thousand dollars. \(^{125}\)

VII. ETHICAL CONSIDERATIONS

*When the price of rescue becomes pauperization, the rescue itself becomes compromised.* \(^{126}\)

Good lawyering involves advising clients on the legal means available to qualify for Medicaid entitlement. \(^{127}\) The Model Rules require lawyers to act with


\(^{122}\) Id.; see also Rapelje's Estate v. Commissioner, 73 T.C. 82 (1979) (including the value of a residence occupied by the decedent during life, but owned by the decedent's children, in the decedent's gross estate pursuant to section 2036).

"Section 1014 applies not only to property held by the decedent at death, but also to some property that decedent transferred during life if the value of the property is nevertheless required to be included in decedent's gross estate for federal estate tax purposes." JAMES J. FREELAND ET AL., FUNDAMENTALS OF FEDERAL INCOME TAXATION 133 (9th ed. 1996).

\(^{123}\) See supra note 66 and accompanying text.


\(^{125}\) See supra notes 106-08 and accompanying text.

\(^{126}\) GORDON, supra note 5, at 19.

\(^{127}\) McEowen, supra note 14, at 112-13 n.61.
diligence in representing a client. Acting with diligence includes pursuing a “matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and may take whatever lawful and ethical measures are required to vindicate a client’s cause or endeavor.” Accordingly, the Model Rules command a lawyer to discuss with a client, concerned about financing long-term care, available options to qualify for Medicaid entitlement, such as the one discussed in this Note.

As one commentator has expressed, “There is no legal obligation to deplete one’s resources paying for one’s medical care when other legal avenues are available.” Similarly, Judge Learned Hand stated when opining a tax planning issue, analogous to Medicaid planning, “Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one’s taxes.” It follows indirectly that one may so arrange his affairs that he or she will qualify for the maximum amount of public assistance.

VIII. Conclusion

Although the utility of the planning technique discussed in this Note depends, in the first instance, on the need for long-term care, prudent estate planners should derive a thorough knowledge of the eligibility criteria for Medicaid entitlement in order to advise clients on how to qualify for benefits. Asset-divestment planning is particularly important to those individuals with resources too high to qualify for Medicaid entitlement but too low to finance long-term care independent of public assistance. As one commentator expressed the dilemma, “[T]here is no system for the middle class.” Medicaid eligibility is premised on legal poverty. Middle-class individuals so wishing to qualify must deplete their


130 McEowen, supra note 14, at 112-13 n.61.

131 Id. (citing Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934), aff’d, 293 U.S. 465 (1935)).

132 See McEowen & Harl, supra note 1, at 1426.

133 Crosby & Leff, supra note 5, at 1504.

134 GORDON, supra note 5, at 6.

135 Bickel, supra note 6, at 23.
resources and thus become legally poor. Compelling an individual to become destitute before Medicaid will assist in the catastrophic costs of long-term care denies that individual “the essence of the middle class view of American life and the American dream.”

The planning technique discussed in this Note shows one way in which middle-class individuals in need of long-term care can deplete their Medicaid estate in order to qualify for Medicaid. Additionally, the asset transfer secures favorable income tax treatment for the donee upon a subsequent sale because the asset receives a stepped-up basis pursuant to section 2036, and the unified transfer credit shields any transfer tax liability for the transferor if the transferor’s total inter vivos and testamentary transfers are less than six hundred thousand dollars.

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136 Crosby & Leff, supra note 5, at 1505.

137 See supra part VI.B.

138 See supra part VI.A.