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Asset Protection with a Medicaid Trust

I am often asked what the difference is between the revocable living trust (“RLT”) and the irrevocable Medicaid trust (“IT”). While there are many different types of IT's, the one we are concerned with here is the IT for Medicaid planning purposes.

In a RLT you, and your spouse if you have one, generally act as the trustees, or managers, of the trust. You can take anything out, or put anything in, at anytime. However, if you can get it, a nursing home can get it. There is only a very limited form of protection from a nursing home getting your assets in a RLT -- that is, if you become disabled, your backup trustee or an agent under your durable power of attorney may be authorized to step in for you and transfer some of your assets out of the trust to other family members. The RLT may be drafted to specifically authorize the back-up trustee to transfer assets to other family members (generally children, not a spouse), in the event you become disabled. By this method, you may be able to protect a portion of your assets. Typically, due to a unique provision in the Code of Virginia, married couples in our state typically use will-based special needs trusts, rather than RLTs, if nursing home admission is likely and resources are limited. (In other words, they create an IT in their wills.)

When you transfer an asset, Medicaid will penalize you for the amount of time you could have paid for yourself (called the "period of ineligibility"). This is the number of months that you *could* have paid for yourself in a nursing home if you had not transferred the asset. In Virginia, the average cost of nursing homes is calculated at $4,060 a month, according to according *very* conservative State estimates. (In reality, these homes charge $5,000-$7,000 per month.) So, under the state formula, if you transfer $40,000, the "period of ineligibility" under Virginia’s Medicaid regulations is 10 months, the amount of time you could have paid for the nursing home yourself with that money. It used to be that, if you had $75,000 to begin with, and you transferred $40,000, you would be ineligible to obtain Medicaid benefits for 10 months, but you could have used the $35,000 you had left to pay for yourself privately for the 10 months that you were ineligible for Medicaid benefits. After the 10 months, you would have run out of money but you’d be eligible for benefits, having saved “half the loaf”. **In general, “Half a loaf” planning no longer works!** For transfers made after February 8, 2006, the Deficit Reduction Act (“DRA”) now provides that the "period of ineligibility" begins when you apply for Medicaid, subject to a five-year “look-back” period. (Gifts made before that date are governed under the prior law.)

With good savings, good health, and/or long-term care insurance, many people would prefer to plan ahead and protect more assets. As people get older, they generally have to confront the possibility of losing some or all of their assets to a nursing home, and they begin to go about surveying their options to protect assets. Nursing home insurance, or long-term care insurance, is a great option if you can afford it and are in good health. If you fail on *either* of those two accounts -- i.e., you cannot afford the premiums or you are medically ineligible for insurance – there may be other options: transfer the assets outright to your children, or set up an irrevocable Medicaid trust. Do not attempt this without the guidance of a qualified elder law attorney, due to the harsh new penalties under the Deficit Reduction Act. If you do make gifts, using a Medicaid trust is better. If you transfer the assets to your children, you lose all control. If they get sued, divorced, have a bankruptcy or die before you, you can lose everything you transfer. Some children would spend your nest egg, or refuse to give it back to you later when you need it.

With the Medicaid trust you are not limited to protecting only "half" of the assets because the principal amount you put into an IT is typically not available for your care, only the income is. Thus, you can protect as much or as little as you like by planning ahead. (Remember: these transfers are now subject to a five year "look-back." The trustees are only the managers, not the owners of the trust. (The trust is the owner). So they cannot spend it. Their creditors or ex-spouses cannot get it. They can only do what the trust allows them to do, which in this case is to pay you the income.

The way that the Medicaid trust protects your assets from a nursing home is by setting up two major roadblocks. First, you appoint someone besides you or your spouse as trustee. People generally appoint one or more of their adult children although it can be any trusted friend, relative or advisor. However, since you retain the right to change the trustee at any time, you are not really giving up control if you have a falling out or don't like the way the trustee is handling your assets. You can simply send them a note advising them that they are being replaced as trustee.

Secondly, you can limit yourself in the IT to the income only. This means that if you put in a C.D., you only get the interest; a stock, only the dividends; or your house, the exclusive right to live there for your lifetime. (If the trust owns a rental property, you receive the net rents.) Like the RLT, the assets in the irrevocable Medicaid trust pass to your beneficiaries on your death, free of the expense and delay of probate.

Even though you cannot take principal out of an income trust -- after all, if you could get it, the nursing home could get it -- that doesn't mean assets cannot be sold. Let's say you want to sell your house in Virginia and buy a condo in Florida. You would direct your trustees to do just that and the trustees would then sell the house in Virginia and buy the condo in Florida in the name of the trust for your benefit, so it is still protected. Similarly, they can sell a C.D. and buy a mutual fund, or sell one stock and buy another. "Irrevocable" does not mean "inflexible".

If someone else (such as your children) creates the trust, limited amounts of principal can also be available.

I hope that this gives you some of the flavor of the differences between the RLT and the IT Medicaid trust, and each one may fit into your plan. But which one is right for you? You should consult with an elder law attorney, and decide for yourself, based on your age, your health and your assets.

GENERAL RULE ALWAYS APPLIES, THE SOONER YOU BEGIN YOUR PLANNING, THE BETTER YOUR RESULTS ARE LIKELY TO BE.

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