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## Policy Memo

<b>KHPA POLICY NO: 2008-03-02</b>	<b>From: Jeanine Schieferecke, Senior Manager, Medicaid Eligibility, KHPA</b>
<b>Date: March 28, 2008</b>	<b>KEESM Reference: 5630</b>
<b>RE: Availability of Non-assignable Annuities</b>	<b>Program(s): Elderly &amp; Disabled Medical</b>

The purpose of this memo is to provide guidance on the treatment of non-assignable annuities which were purchased by or on behalf of an institutionalized individual or their spouse with a lump sum payment in exchange for an immediate income stream. These provisions are effective with all decisions made on or after the issuance date of this memo.

**A. Background** – Annuities have long been employed as a Medicaid estate planning tool in an attempt to artificially impoverish an individual or couple in order to qualify for assistance. Acknowledging that Medicaid should be reserved for the truly needy (see the KHPA Memo – Guidelines Regarding Medicaid Planning Advice, dated 2-16-2007), new stricter rules governing annuities were enacted with passage of the federal Deficit Reduction Act (DRA) of 2005. Those rules essentially state that an annuity purchased by or on behalf of an institutionalized individual on or after 2-8-2006 who has applied for medical assistance will not be treated as an inappropriate transfer of assets if the annuity meets all of the following requirements:

1. The annuity is irrevocable and non-assignable in that it cannot be cashed in with the issuing company nor ownership transferred to another individual or entity;
2. The annuity is actuarially sound in that it is expected to return full principal and interest within the institutionalized individual's life expectancy;
3. The annuity provides payments in approximately equal amounts with no deferred or

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State Self Insurance Fund:

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balloon payments;

4. Kansas Medicaid has been named the first remainder beneficiary of the annuity for the total of medical assistance paid by Medicaid for the institutionalized individual.

An annuity purchased by or on behalf of a community spouse need only meet one requirement so as not to be treated as an inappropriate transfer – Kansas Medicaid must be named as the first remainder beneficiary of the annuity for the total of medical assistance paid by Medicaid for the institutionalized individual.

While the funds used to purchase an annuity properly structured to meet the above detailed requirements will not be considered an inappropriate transfer of assets, the annuity itself must still be evaluated as to its accessibility as a resource for eligibility purposes. If the annuity is considered to be inaccessible, the periodic payments received are counted as unearned income. If the annuity is deemed accessible, it is a countable resource and the periodic payments would not be counted as income.

**B. Accessibility** – Any annuity purchased with a lump sum payment in exchange for an immediate income stream will be considered to be an accessible resource.

1. **Retirement Annuities** – Retirement and pension annuities such as Civil Service and Railroad Retirement annuities are not considered to be accessible. These annuities meet the requirements for favorable tax treatment under the Internal Revenue Code and are non-transferrable. Qualifying retirement annuities are specifically exempt as a resource. The payments received from a retirement annuity are countable unearned income.

2. **Assignable Annuities** – Ownership of an assignable annuity can be transferred to another individual or entity and therefore is considered accessible. The resource value of the annuity is:

- a. **Revocable** – If the terms of the contract allow for the annuity to be surrendered or cashed-in with the issuing company, the annuity is considered revocable. The resource value of a revocable assignable annuity is the cash surrender value reported by the issuing company. The ES-3167A Annuity Information Request form shall be used to obtain that amount.

- b. **Irrevocable** – If the terms of the contract do not allow for the annuity to be surrendered or cashed-in with the issuing company, the annuity is considered irrevocable. The resource value of an irrevocable assignable annuity is deemed to be the total amount yet to be paid out under the contract. The Annuity Evaluation Worksheet shall be used to compute that amount.

NOTE: The initially assigned agency value of the annuity may be reassessed if the individual can provide evidence from a reliable source documenting a lesser fair market value.

3. **Non-assignable Annuities** – Ownership of a non-assignable annuity cannot be

transferred to another individual or entity. However, the right to receive the income stream from the underlying annuity can be sold on the open market and therefore is considered accessible.

- a. Revocable** – If the terms of the contract allow for the annuity to be surrendered or cashed-in with the issuing company, the annuity is considered revocable. The resource value of a revocable non-assignable annuity is the cash surrender value reported by the issuing company. The ES-3167A Annuity Information Request form shall be used to obtain that amount.
- b. Irrevocable** – If the terms of the contract do not allow for the annuity to be surrendered or cashed-in with the issuing company, the annuity is considered irrevocable. The resource value of an irrevocable non-assignable annuity is deemed to be the total amount yet to be paid out under the contract. The Annuity Evaluation Worksheet shall be used to compute that amount.

NOTE: The initially assigned agency value of the annuity may be reassessed if the individual can provide evidence from a reliable source documenting a lesser fair market value.

**C. Sheltering Techniques** – Several resource sheltering techniques involving the purchase of immediate annuities are being employed by Medicaid estate planners on behalf of individuals in an attempt to shelter otherwise countable resources and qualify for assistance without having to otherwise spend down those resources. These wealth transfer methods only work in instances where the newly purchased annuity is considered an unavailable resource.

A few of the most common mechanisms are listed below. The sole intent of purchasing these annuities is to shelter resources and qualify for Medicaid. None of these are effective in Kansas because any annuity purchased with a lump sum payment in return for an immediate income stream will be considered a countable resource. These examples are being presented for illustrative purposes only.

1. A single individual with excess resources purchases an immediate irrevocable non-assignable annuity with those excess resources. The annuity is actuarially sound, payments are in equal amounts with no deferred or balloon payments, and the state has been named the remainder beneficiary. If the annuity was not considered an available resource, the individual would be immediately eligible for assistance without having to spend down resources.

The benefit to the individual under this method is that their estate would be reimbursing Estate Recovery at the nursing home state rate upon death rather than expending the otherwise available resources at the presumably higher private pay rate in the spend down process.

2. A single individual with excess resources gifts a portion of those resources to a family member with the intent to incur an immediate penalty. To facilitate imposition of the penalty, the remaining excess resources are used to purchase an immediate irrevocable non-assignable annuity. The annuity is actuarially sound, payments are in equal amounts with no deferred or balloon payments, and the state has been named the remainder beneficiary. The annuity pay out is structured to coincide with the length of the transfer penalty. If the annuity was not considered an available resource, an

inappropriate transfer penalty would be imposed on the gifted resources because the individual would otherwise be eligible for assistance.

The benefit under this method is that the individual would be able to shelter a portion of their resources by gifting them away while retaining enough resources via the newly purchased annuity to survive the penalty period. This method is known as “half-a-loaf” with the notion that it is better to protect half the resources than none at all.

NOTE: In the “half-a-loaf” method, if the annuity is considered a countable resource, the inappropriate transfer penalty for the gifted amount would not be imposed because the individual has excess resources and is therefore not otherwise eligible for assistance. The transfer penalty would not be applied until the annuity resources had been expended.

3. A married individual with excess resources purchases an immediate irrevocable non-assignable annuity in the name of the community spouse in an amount equal to the amount in excess of the community spouse resource allowance. The state has been named the remainder beneficiary. If the annuity was not considered an available resource, the individual would be immediately eligible for assistance without having to complete a spend down of resources.

The benefit under this plan is that the couple would be able to totally shelter every resource they own with absolutely no spend down of resources required. The long term care spouse would be immediately eligible for assistance. This plan is known as “full-loaf” since all of the resources are protected.

**D. Transfer Penalty** – Immediate imposition of an inappropriate transfer penalty is the key element for many of the resource sheltering techniques involving the purchase of annuities. The timing of the penalty is all important. The reason for this is because with implementation of the DRA of 2005 transfer provisions, the penalty period start date changed from the month the transfer occurred to the date the individual would otherwise be eligible for Medicaid coverage of long-term care expenses.

What this means is that if a non-assignable annuity purchased to shelter otherwise non-exempt excess resources is considered a countable resource, then the inappropriate transfer penalty would not be applied. The individual would be over the resource limit and not otherwise eligible for payment of long-term care services. The penalty would not be applied until countable resources are within the allowable limit.

Listed below are reasons why an individual may not otherwise be eligible for Medicaid coverage of long-term care expenses making immediate application of a transfer penalty inappropriate. This list is not intended to be all inclusive as additional reasons may apply.

1. Failure to cooperate and/or supply information necessary to determine eligibility;
2. Failure to pursue potential resources;
3. Patient liability exceeds the cost of care;

4. Living in a non-Medicaid approved facility;
5. Failure to meet the level of care requirement.

Again, in these instances, application of the penalty is not waived but is delayed until the individual would otherwise be eligible for Medicaid coverage of long-term care expenses.

**E. The Market** – Single premium immediate annuities (also known as non-qualifying annuities) are considered an available resource for Medicaid purposes. The underlying annuity contract and the resulting income payment stream generated by the annuity both have value as an asset on a secondary market. In general, retirement and pension annuities (also known as qualifying annuities) cannot be sold on the secondary market and therefore are not an available resource.

Definitions:

1. **Receivables** – A receivable is the legal right to be paid money under the terms of a contract. The right to an income payment stream produced by an annuity is a receivable. Any individual or company may purchase the right to this income payment stream.
2. **Factor** – A factor is a company or individual who buys receivables, including annuity income payment streams, at a discount. The factor completes a market analysis of the annuity to determine the present lump sum value of the right to the future payments.
3. **Factors Market** – The factors market is one place that the rights under an annuity contract may be bought and sold. Companies and individuals nationwide will pay a lump sum amount in return for the right to receive the future annuity payments. The right to the income payment stream may be sold in this market even if the annuity is irrevocable or non-assignable.

Assignable Annuity – If the terms of the contract allow the annuity to be assigned to another individual or entity, then the owner can sell the right to the payments outright to a willing buyer in the factors market.

Non-assignable Annuity – If the terms of the contract state that the annuity is non-assignable, then the right to the payments cannot be sold or transferred directly to another individual or entity. However, the right to the payments from the income stream as a receivable can be encumbered and re-directed to a factor in the factors market.

A listing of factor companies in the business of buying and selling these annuities can be found by completing a simple on-line internet search. Many of these companies offer a free on-line quote as to the current value of the future annuity payments.

**F. Processes** – The eligibility worker shall continue to send all annuities to the KHPA Medical Assistance Manager for review. The following information shall be submitted:

1. The Request for Trust/Annuity Clearance form (Item B-6 in the KEESM Appendix) fully completed by the eligibility worker (including indicating if any other transfer of assets has also occurred);

2. Screen prints of CAP1 and CAP2 from the KAECSSES system;
3. A complete copy of the annuity contract; and
4. The ES-3167A (Annuity Information Request) form completed by the annuity company.

The annuity will be evaluated by KHPA to determine accessibility as a resource and whether any inappropriate transfer has occurred. The eligibility worker shall not take any case action until receiving a response back from KHPA.

Inaccessible – If the annuity is determined to be inaccessible, it is an unavailable resource. The payments received would be countable unearned income to the individual receiving the payments.

Accessible – If the annuity is determined to be accessible, it is an available resource. The resource value would be computed as outlined in section B. of this memo. The payments would not be counted as income to the individual receiving the payments.

The following special processes are required for determining the resource value of irrevocable non-assignable annuities that have been determined to be an available resource and the individual either disagrees with its availability or with the valuation determined by the agency:

1. The valuation shall initially be deemed to be the total amount yet to be paid out under the contract. The Annuity Evaluation Worksheet shall be used to compute that amount. A determination of eligibility shall be based on this figure.
2. The individual may challenge the agency valuation by submitting three (3) separate lump sum purchase offers from commercial factors in the business of purchasing such receivables. The agency may accept the highest of the three (3) offers as an alternative valuation if it appears that the individual made a good faith effort in soliciting the offers.
3. The agency may solicit additional offers should it dispute the purchase offers submitted by the individual or suspects that a good faith effort was not made by the individual in obtaining the offers. The highest offer obtained in this process shall be used as the resource value of the annuity. Eligibility shall then be redetermined based on this new valuation.
4. Should the individual disagree with the agency decision to consider the annuity an available resource or with the valuation based on the agency's solicitation of purchase offers, they have the option of requesting a fair hearing. The agency decision is final at this point subject to the fair hearing process.

Should you have any questions about this memo or the treatment of annuities, please contact Tim Schroeder at (785) 296-1144 or Tim.Schroeder@khp.ks.gov.