

## **Section 3**

# **MEDICAID AND TAX-PLANNING**

Prepared By

Jessica L. Mellington, Attorney

Rhonda V. Bridgeman, Paralegal

**LAW OFFICE OF MARTIN J. GANDERSON**

409 Bank Street

Suite 200

Norfolk, Virginia 23510

Telephone (757) 622-0505

Facsimile (757) 627-8782

Presented By

Martin J. Ganderson

**LAW OFFICE OF MARTIN J. GANDERSON**

409 Bank Street

Suite 200

Norfolk, Virginia 23510

Telephone (757) 622-0505

Facsimile (757) 627-8782

**I. WHO IS SEEKING TO QUALIFY: PARENT, SPOUSE, CHILD**

In Virginia, the duty to support family is a legal obligation. When necessitous circumstances arise, family members in need, whether a spouse, child, or parent, have a legal right to support by certain members of their families, unless a limited exception applies. When making a determination of whether or not a duty of support exists, it is important to be familiar with the applicable sections of the Code of Virginia.

**A. SUPPORT OF HUSBAND, WIFE, AND CHILDREN**

Any spouse who without cause deserts or willfully neglects or refuses or fails to provide for the support and maintenance of his or her spouse, and any parent who deserts or willfully neglects or refuses or fails to provide for the support and maintenance of his or her child under the age of eighteen years of age, or child of whatever age who is crippled or otherwise incapacitated from earning a living, the spouse, child or children being then and there in necessitous circumstances, shall be guilty of a misdemeanor . . . This section shall not apply to any parent of any child of whatever age, if the child qualifies for and is receiving aid under a federal or state program for aid to the permanently and totally disabled . . . and for this purpose any state agency shall use only the

financial resources of the child of whatever age in determining eligibility. <sup>1</sup>

**B. SUPPORT OF PARENTS BY CHILDREN**

It shall be the joint and several duty of all persons eighteen years of age or over, of sufficient earning capacity or income, after reasonably providing for his or her own immediate family, to assist in providing for the support and maintenance of his or her mother or father, he or she being then and there in necessitous circumstances . . .

This section shall not apply if there is substantial evidence of desertion, neglect, abuse or willful failure to support any such child by the father or mother, as the case may be, prior to the child's emancipation or, except as provided hereafter in this section, if a parent is otherwise eligible for and is receiving public assistance or services under a federal or state program.

To the extent that the financial responsibility of children for any part of the costs incurred in providing medical assistance to their parents pursuant to the plan provided for in § 32.1-325 is not restricted by that plan and to the extent that the financial responsibility of children for any part of the costs incurred in providing to their parents services rendered, administered or funded by the Department of Mental Health, Mental Retardation and Substance Abuse Services is not restricted by federal law, the provisions of this section shall apply. A proceeding may be instituted in accordance

---

<sup>1</sup> Va. Code § 20-61.

with this section in the name of the Commonwealth by the state agency administering the program of assistance or services in order to compel any child of a parent receiving such assistance or services to reimburse the Commonwealth for such portion of the costs incurred in providing the assistance or services as the court may determine to be reasonable. <sup>2</sup>

## II. QUALITY OF CARE vs. QUALIFYING FOR MEDICAID

### A. QUALITY OF CARE

Beyond determining whether or not someone meets the criteria necessary to qualify for Medicaid, he or she should consider the advantages and disadvantages of qualified Medicaid nursing home care versus private nursing home care.

#### *1. Cost Considerations*

Often the costs associated with private nursing home care are significant such that careful consideration should be given to an individual's income and available resources, as well as to the income and available resources of any other person(s) who is presently, or may in the future be, supporting the individual. Depending upon these financial

---

<sup>2</sup> Va. Code § 20-88.

resources, and since Medicare covers only a limited percentage of all nursing home costs, it is quite possible that an individual may quickly exhaust all financial resources, such that he or she can no longer afford to receive private nursing home care.

Average nursing home fees in Northern Virginia are \$5,403.00 per month, while the average nursing home fees in other parts of Virginia are \$4,060.00 per month. <sup>3</sup> Using these same amounts, average annual nursing home fees are \$64,836.00 in Northern Virginia and \$48,720.00 in the rest of Virginia.

## ***2. Quality of the Nursing Home***

Another important consideration is the quality of care a nursing home facility can provide, as well as the quantity of services offered by the facility, especially since not all nursing homes will accept Medicaid recipients. One of the most advantageous aspects of a private pay nursing home is the likelihood of better quality of care associated with such private pay nursing facilities. Private pay

---

<sup>3</sup> Krause Financial Services, Medicaid Desk Reference (2004).

nursing homes often value quality of care considerations over cost of care considerations and therefore are better equipped to offer more amenable facilities to their residents. Although the cost of a private pay nursing home facility may be high, the benefits made possible by the additional expense are evident in many aspects of nursing home life, including, but not limited to, quality of food, cleanliness, lack of unpleasant odor, available amenities, and the ratio of staff and nurses to nursing home residents.

As one might expect, the quality of food at a nursing home is a reflection of the cost of residing at that nursing home. Private pay nursing homes likely offer higher quality food, as well as more variety, and even greater portions, to their residents than a qualified Medicaid only nursing home.

By increasing their costs, private pay nursing homes can also ensure more regular cleaning services, thus creating a more desirable and appealing atmosphere for their residents. Cleanliness helps

eliminate germs and bacteria that the facility is harboring and also significantly decreases the likelihood of undesirable odors and germs emanating throughout the facility.

Another considerable advantage that exists with regard to many private pay nursing care facilities is the placement of amenities, such as pharmacies and beauty parlors, within the nursing home grounds themselves so that residents do not have to travel to have access to such amenities. By locating such amenities within the nursing home grounds, the amenities are more readily accessible to residents and residents have the opportunity to socialize with other residents in a less-restricted, and often more enjoyable, atmosphere. The availability of accessible amenities also serves to eliminate the need for transporting residents that may have special needs, thus making it easier for those residents to have a better quality of life in their golden years.

Private pay nursing homes are also more often equipped with a higher staff/nurse ratio to resident.

The provision of more staff members and nurses enables such employees to develop a more intimate relationship with each resident under their care, while also ensuring that someone will be able to more closely monitor each resident's personal needs. The availability of one-on-one care is more likely in this type of setting and allows for more personalized care. In addition, general needs such as bathing, toileting, and feeding are taken care of on a more regular basis, thereby increasing the resident's cleanliness and comfort level.

With all these factors in mind, an individual, along with his or her family, may find it beneficial to tour several nursing home facilities to get a better understanding for each facility and its amenities. Individuals and/or family members should consider making unscheduled visits in order to view the nursing home facility in its normal course of business to ascertain the true atmosphere of the facility. The applicant may also find it beneficial

to call several nursing homes and request a detailed schedule of the services rendered by the nursing home.

### ***3. Miscellaneous Considerations***

In addition to the financial situation of the individual, factors exist that deserve consideration before any decision is made between a qualified Medicaid nursing home and a private pay nursing home.

The locality of the nursing home is important since it often plays an important role in how frequently family members and friends are able to visit the nursing home resident.

Another important consideration is the well-being of the community spouse. Although Medicaid places stringent restrictions on the amount of assets that the community spouse is allowed to keep, private pay nursing home expenses may eventually deplete not just some, but all, of the community spouse's assets, such that he or she can no longer afford the expenses of daily living.

## **B. QUALIFYING FOR MEDICAID**

Before submitting an application seeking to qualify for Medicaid and its associated benefits, one should first determine if he or she meets the minimal standards necessary for such qualification. In Virginia, several requirements must be satisfied before a person can qualify for Medicaid, including: <sup>4</sup>

1. Covered Group
2. Nonfinancial Requirements
3. Resource Limits
4. Income Limits

### **1. Covered Group**

To qualify for Medicaid benefits in Virginia, an applicant must fall into one of the following categories:

1. Mandatory Categorically Needy
2. Optional Categorically Needy
3. Medically Needy

### **2. Non-financial Requirements**

Medicaid is generally only available to United States citizens, although, under certain circumstances, a person may meet the "qualified alien"

---

<sup>4</sup> Virginia Medicaid Manual § M0810.001.

criteria, and as a result, he or she may also qualify for Medicaid and its benefits. Although only United States citizens and qualified aliens are eligible to receive Medicaid and its benefits to their fullest extent, certain other non-qualified aliens are eligible to receive the benefits of Medicaid for emergency services.

The Virginia residency test simply requires that the Medicaid applicant be a resident of the state in which he or she is applying for Medicaid and that the applicant has the intent to reside in said state for an indefinite period of time.

### ***3. Resource and Income Limits***

Medicaid eligibility is determined for each calendar month, which determination requires differentiation between an applicant's resources and income. A resource refers to what is owned by an individual prior to the month in question, while income refers to what is received by an individual during the month in question.

To be eligible for Medicaid, an applicant, whether single or married, must have no more than \$2,000.00 in countable assets. <sup>5</sup> However, certain exceptions apply to protect the spouse of a nursing home resident, also known as the "community spouse". The community spouse is entitled to one half of the couple's joint assets up to \$92,760 for the year 2004, according to current Medicaid standards in Virginia, although these numbers may change from year to year to reflect inflation. In addition, the community spouse may keep the first \$18,552 in assets, even if this figure is greater than one-half of the couple's assets. <sup>6</sup>

The Medicaid recipient is entitled to keep a monthly stipend from his or her income, while the remaining income is paid to the nursing home facility to defray the cost of the nursing home care. Medicaid pays the difference between the cost of care and the recipient's income (after subtracting the stipend).

---

<sup>5</sup> Virginia Medicaid Manual § M0610.002.

<sup>6</sup> Virginia Medicaid Manual § M1480.231.

### **III. IDENTIFICATION OF TAX ISSUES**

Long-term care planning, including qualification for Medicaid when applicable, requires an in-depth look at the potential tax ramifications associated with different avenues of action available to effectively and efficiently plan for the future. Certain tax implications are triggered by gifting, by purchasing a long-term care insurance policy, and by estates in excess of a certain value.

The information in the following paragraphs, Paragraphs A. through C., is intended only as a general introduction to the pertinent tax issues since each of the aforementioned scenarios is covered in greater detail in other sections.

#### **A. GIFTS**

Making gifts can be a very effective technique for minimizing taxes. A donor may make as many gifts as he or she desires, and, so long as the value of gifts per donor, per donee, each year does not exceed the \$11,000 annual exclusion limit, the gifts are not taxed for federal tax purposes. However, if gift(s)

by a donor to any one donee in a single year exceeds the \$11,000 limit, the gift(s) must be reported to the IRS by filing a gift tax return.

In addition, only the future earnings from a gift, not the gift itself, are treated as taxable income to the donee.

#### **B. LONG-TERM CARE INSURANCE**

If a taxpayer chooses to itemize, and the long-term care insurance policy is qualified, the premiums are deductible up to a maximum amount, which amount varies depending upon the policy holder's age at the end of the year, subject only to the succeeding sentence. The cost of premiums, plus all other medical expenses, must exceed 7.5% of the taxpayer's adjusted gross income in order to take advantage of the deduction.

The benefits received pursuant to a long-term care insurance policy are generally not taxable income as long as the policy is qualified.

### **C. ESTATE TAXES**

The unified credit is an exemption applied to the cumulative dollar amount of taxable gifts and transfers at death. As long as this cumulative amount does not exceed the exemption equivalent specified for the applicable year, the estate will not be subject to federal estate taxation. However, any amount in excess of the exemption equivalent will be subject to federal estate taxation at the tax rate specified for the applicable year.

In addition, certain transfers to spouses and qualified charities are not taxed.

### **IV. SELECTING A MECHANISM FOR TRANSFERRING ASSETS AND UNDERSTANDING THE TAX IMPLICATIONS.**

The thought of disposing of assets is very unsettling to most Americans in our society. It is difficult to deal with issues surrounding an individual's (i) getting older, (ii) having to rely on family members or others for help, or (iii) the ultimate in dependency, becoming incapacitated. These are serious issues that need to be addressed before the onset for need of care to allow for the wishes of

the individual to be accomplished. It is much easier for family members to carry out an individual's wishes if such wishes are known before the need for care arises.

**A. TIME AS AN ASSET**

The statistical ratio for the need for some type of care for our elderly population is high enough that members of society should be aware of the possibility that either such individual, his or her spouse, or some other loved one will be in a position to need some type of care at some point in time. It is important to identify goals as early as possible to attain the maximum benefit allowable under Virginia law. That is not to say that there are not methods to help individuals who may have a need for planning due to issues which arise unexpectedly. The gift of time is crucial to obtaining the optimal benefits, but there certainly may be benefits obtainable without the gift of time. Each individual situation is unique and must be addressed accordingly. An elder law attorney may be able to suggest a strategy which will result in

saving a large amount of resources for an individual's spouse or children should the individual desire. Utilizing an experienced elder law attorney may also save valuable time in identifying the best planning option(s) available for each individual situation.

#### **B. MONETARY CONSEQUENCES**

If there has been no long-term care planning, many people will expend much of their own resources should the need for care arise (whether it be for in-home care or nursing home care). Assisted living is very costly and many Americans will use basically all of their own resources before qualifying for Medicaid. If you do not have a spouse, or you do not have children for whom you may wish to provide, this may be acceptable to you. However, if you do not wish to exhaust basically all of your resources should the need for care arise, there are avenues for the transfer of assets allowed under current Medicaid law in Virginia that may be advantageous for an individual to consider. However, bear in mind that the gift of time is crucial for optimal satisfactory planning.

### **C. ELIGIBILITY OF TRANSFERS**

It is important to understand that any time uncompensated transfers are made there will be a look back period from the date of such transfer. The look back period in the state of Virginia is normally thirty-six (36) months for individual transfers and sixty (60) months if the transfer is made to or from a trust. The best case scenario for Medicaid planning is to have a three to five year window in which to plan. This will allow for an individual to utilize a myriad of planning techniques to accomplish his or her goals, as well as those of his or her family. It is important to make any transfers well in advance of the need for Medicaid benefits to ensure that there will not be a period of ineligibility. To make transfers you must be willing to do so and mentally competent to do so.

### **D. HOPE IN THE ABSENCE OF TIME**

However, it may still be possible to protect some portion of an individual's assets even if there is not the optimal time frame in which to accomplish the

maximum savings of assets prior to becoming eligible for Medicaid and its ensuing benefits. There are always situations that arise suddenly that do not allow for the most efficient, cost effective transfers prior to the need for Medicaid eligibility. There are options that, in some instances, exist for allowable transfers under Medicaid guidelines within the look back period. Some types of transfers that are utilized in this type of scenario may result in a certain period of ineligibility for Medicaid which would result in the individual being responsible for a certain portion of the cost for a limited period of time which is referred to as a penalty period.

#### **E. POWER OF ATTORNEY**

There are various types of Power of Attorneys that may be utilized in elder law planning. The following are examples of types of power of attorneys that an individual may desire to have in place in the

event that he or she cannot make decisions for himself or herself:

1. General Power of Attorney
2. Advance Medical Directive
3. Durable Medical Power of Attorney
4. Special Power of Attorney

Each of these power of attorneys address specific rights and privileges which an individual will entrust to the holder of the power. The existence of such documents is crucial should an individual not be able to make decisions on his or her own behalf for one reason or another.

As an example, an individual may find it useful to have a General Power of Attorney in the event he or she goes out of the country so that someone has the authority to make financial decisions on his or her behalf. An individual may wish a Durable Medical Power of Attorney which addresses decisions of a medical nature to be made by one or more designated individuals in the event he or she becomes incapacitated. Advance Medical Directives are also crucial in the event one suffers from a terminal condition and is unable to make medical decisions with

regard to his or her own health. It is helpful to know an individual's wishes with regard to life support and organ donation. These issues are also time sensitive and in most cases immediate action must be taken. Special Power of Attorneys are often used for a limited act (such as in real estate transactions) where, as an example, the seller may not be able to be at his or her real estate closing, and designates a representative who has the authority to act in his or her absence.

#### **F. IMPORTANCE OF PROFESSIONAL ADVICE**

No matter what the situation, it is important to secure proper legal advice before any attempts are made to make transfers with the hope of becoming eligible for Medicaid. The consequences of hasty decisions may be irreversible and adverse. All assets of the individual need to be examined to determine the correct tools to effectuate the most beneficial transfers. The goals of the individual are most important.

In any event, transfers should be made with professional advice and under careful consideration. The individual's goals for one or more transfers are important to the selection of a transfer mechanism.

A large stumbling block for transfers is that one must give assets away. The only transfers that can sometimes be utilized without giving up total control are transfers to trusts. When transfers are made to a trust, those trust assets must be administered by the trustee of the trust in accordance with the provisions of the trust instrument. This may be a very effective way for individuals to transfer assets for a specific purpose without the individual retaining direct control of the assets. The disadvantage here is a look back period of sixty (60) months versus thirty-six (36) months.

#### **G. TAX CONSEQUENCES**

It is important to realize the legal implications of any transfer. For instance, if you make transfers to children directly, the asset that is transferred (whether it be currency, stocks, bonds, or real

property) becomes the property of that individual. You will no longer be able to use those assets for your needs. Most people believe that their family members will always take care of them and provide for their needs. This train of thought can be derailed by bankruptcy, divorce, death, liens, or a lawsuit. Most people do not take into account factors such as these for which the individual may or may not have control. It is best to plan for the worst and still have a certain comfort level in such event.

In addition to realizing the legal implications of making a transfer, one should also understand the tax consequences of such transfers. Important tax considerations include the resultant tax basis of the property, which basis varies depending upon whether the transfer is made *inter vivos* or whether the property passes through an estate, as well as the tax brackets and how they can affect the income received from the sale of property.

Example: John Doe plans to make a gift to Jane Doe equal in value to the net income

from selling stock currently valued at \$25,000.00. Without regard to the holding period and its possible effects, and assuming the sale of stock would result in short term capital gain, if John Doe, the donor, is in a higher income tax bracket than Jane Doe, the donee, then it may be more advantageous for John Doe to make a gift of the stock itself to Jane Doe. Since Jane Doe is in a lower income tax bracket than John Doe, she would net more from a sale of the stock than John Doe would net from a sale of the stock.

Although the tax implications of a transfer are important, such tax implications should play a lesser role in the attempt to achieve Medicaid qualification, while the well-being of the Medicaid applicant should be the foremost consideration. Oftentimes, this priority is lost in a mix of tax considerations and decisions are made that do not give adequate

consideration to the well-being of the Medicaid applicant.

**V. ASSETS: MAKING OF GIFTS vs. PLACING IN TRUST(S)**

Although transferring assets may seem simple, the processes by which such transfers occur, and the consequences associated with such processes, are oftentimes much more complex than originally contemplated, depending upon the goals of the transferor. Consideration of tax implications and qualification for Medicaid may help determine the most desirable means for transferring one's assets.

When deciding between transfer via gift and transfer via trust, one should carefully consider the potential tax consequences associated with each means of transfer, not only for the potential effect(s) on the transferor, but also for the potential effect(s) on the transferee(s).

The means of transferring assets may also be integral to qualification for Medicaid. Effective Medicaid planning within the realm of transferring assets can help ensure that the applicant's savings go

to his or her family and friends, rather than being expended on the costs of nursing home care.

In addition to the means for transferring assets, the timing of the transfer is key to ensuring that a Medicaid applicant is not unnecessarily penalized for making transfers within the applicable look back period.

#### **A. GIFTS**

##### ***1. Medicaid Qualification***

When applying for the benefits of Medicaid, an applicant should be aware that the transfer of assets via gift may negatively impact his or her Medicaid qualification status. To discourage applicants from transferring assets in order to qualify for Medicaid, Congress implemented a penalty for transferring assets for less than adequate consideration, although there are certain enumerated transfers that are excepted from this penalty. The transfer penalty is a period of time during which the applicant will not be eligible to receive Medicaid benefits.

Early planning for Medicaid qualification is important to avoid implication of the transfer penalty period by the Medicaid agency for the state in which the applicant is seeking benefits. However, if the transfer penalty is invoked, the look-back period is limited to transfers made during the thirty-six (36) months preceding the application for Medicaid, and sixty (60) months preceding the application for Medicaid for certain trusts, by the applicant or his or her spouse.

## **2. Tax Basis**

Another consideration related to gifting is the resultant tax basis. Upon making a gift, the donee receives the property with a carry-over basis equal to the basis of the donor, although a special rule applies when the property is later sold by the donee at a loss. However, if the donor postpones the making of the gift and instead transfers that same property at death by means of his or her Last Will and Testament, then the donee will take the property with

a step-up in basis, equal to the fair market value of the property at the time of the death of the testator.

By transferring property at death, rather than during one's lifetime, the donor enables the donee to receive the property with a step-up in basis and thus incur less tax when the property is later sold (assuming the property appreciates in value).

## **B. TRUSTS**

### ***1. Revocable Trusts***

A revocable trust is a trust instrument created by the Grantor during his or her lifetime, which sets forth instructions concerning the management of assets contributed to the trust, and which grants authority to one or more trustees (oftentimes the Grantor acts as the initial trustee) to carry out those instructions. As evident from its name, a revocable trust can generally be amended or terminated at the election of the Grantor, at any time (so long as the Grantor is competent), in accordance with the terms of the trust.

Since the Grantor has the ability to amend or revoke the trust at anytime during his or her life, the Grantor continues to maintain control over the assets held by the trust. *Thus, the trust assets will be considered countable assets for purposes of Medicaid qualification.*

## **2. Irrevocable Trusts**

Like a revocable trust, an irrevocable trust is a trust instrument created by the Grantor during his or her lifetime, which sets forth instructions concerning the management of assets contributed to the trust, and which grants authority to one or more trustees (the Grantor should not designate himself or herself as trustee) to carry out those instructions. However, unlike a revocable trust, an irrevocable trust normally cannot be later amended or revoked at the election of the Grantor, or any other party.

*Even so, an irrevocable trust created by an individual, or his or her spouse, and for the benefit of the individual, or his or her spouse, is considered a Medicaid qualifying trust ("MQT"). The assets of*

*the irrevocable trust are considered available to the individual, or his or her spouse, for purposes of Medicaid qualification, in an amount equal to the maximum amount of principal and income that the trustee has discretion to pay to either the individual or his or her spouse.*

*However, testamentary trusts are not considered Medicaid qualifying trusts. A testamentary trust is created for the benefit of the testator's surviving spouse, but its terms limit the trustee's discretion, such that the trustee is not entitled to make any distributions to the surviving spouse that might put his or her Medicaid eligibility at risk. The trustee may use trust assets to provide the individual with benefits not covered by Medicaid, but the trustee does not have discretion to use the trust assets to provide the individual with benefits which would disqualify him or her from Medicaid.*

#### **C. STAYING CURRENT WITH MEDICAID**

Expanding a law firm to include Medicaid related services can greatly enhance the diversity of a law

firm's practice areas, although such work is quite complicated and requires much dedication.

The laws governing Medicaid, both federal and state, are subject to change at any time and thus an attorney involved in Medicaid must stay abreast of the law as well as understand that a Medicaid related decision in accordance with the law at the time of its execution is not necessarily in accordance with the law the day after its execution. In light of such potential changes, an attorney must decide whether or not a duty exists to contact a healthy, mentally competent client to inform him or her of changes in the law that may affect prior work done for that same client.

An attorney doing Medicaid related work should stay current, be aware of new interpretations of, as well as new additions, deletions, or amendments to, current law, be familiar with the applicable provisions of tax-related law, such as income and estate and gift tax consequences, and consult the Medicaid Manual.

## **VI. TAXATION OF LONG-TERM CARE INSURANCE BENEFITS**

### **A. INTRODUCTION**

In today's society, the elderly population is the fastest growing sector of our population. Taking this into account, a major concern of today's population is the possibility of ending up in a nursing home, which entails not only a loss of autonomy, but also creates a substantial financial burden. However, with early and effective long-term care planning, many individuals can lessen the likelihood of both a lack of autonomy and the incurrence of great financial expense.

### **B. COST AND COVERAGE**

Although Medicare is an entitlement program, its benefits are limited, covering just up to one hundred (100) days of skilled nursing care per incident of illness. Unlike Medicare, Medicaid is not an entitlement and each individual must meet certain requirements before qualifying for its benefits.

Long-term care insurance frequently expands its coverage to include not only nursing home costs, but

also home care expenses and assisted living expenses. However, long-term care insurance, like Medicare and Medicaid, has a setback(s). The major setback of long-term care insurance is the cost of purchasing such a policy. However, the cost of purchasing and maintaining a long-term care insurance policy is most often worthwhile, enabling individuals to pass along an inheritance to their loved ones, rather than expend all of their savings on nursing home expenses not covered by either Medicare or Medicaid.

Another concern of effective long-term care planning is making sure one purchases enough insurance coverage; if not, he or she may later have to deplete his or her savings to qualify for Medicaid. In addition to purchasing sufficient coverage, an individual must be sure that the coverage is expansive enough to cover home care expenses and assisted living expenses in addition to nursing home expenses. Otherwise, purchasing a long-term care insurance policy is not fully effective, since it covers only that which is traditionally covered by Medicaid. To

alleviate this potential problem, one should consider purchasing a home care option or rider as part of his or her long-term care insurance policy.

### **C. QUALIFICATION OF THE INDIVIDUAL**

Having sufficient funds to cover the premiums for a long-term care insurance policy does not guarantee an individual coverage. An individual must also qualify for long-term care insurance. The best way to ensure qualification is to purchase a long-term care insurance policy early, ideally between the ages of forty and fifty. Purchasing this type of insurance early minimizes the financial burden of owning a policy since the determination of the initial premium for the long-term care insurance policy tends to increase relative to increases in age. In addition, the risk of developing a condition that may disqualify an individual from coverage increases with his or her increase in age.

#### **D. INDIVIDUAL VERSUS GROUP INSURANCE POLICIES**

An individual insurance policy is between the policy holder and the insurance company, while group insurance is between the insurer and the group. At first glance, group insurance may seem more desirable because of its less costly premiums, but individual insurance offers more specialized coverage.

Group insurance is often more cost effective, but because it is less costly, group insurance is limited in the expanse of coverage it provides to individual members of the group. On the other hand, individual insurance policies offer more comprehensive coverage to its holders and enable holders to purchase a policy that is more closely tailored to their long-term care needs.

#### **E. TAX IMPLICATIONS**

In accordance with the *Health Insurance Portability and Accounting Act of 1996*, qualified long-term care insurance policies now receive more favorable tax treatment.

**1. *Qualified Long-Term Care Insurance Policies***

Policies purchased before January 1, 1997 are grandfathered and considered "qualified", subject only to the requirement that each policy be approved by the insurance commissioner of the state in which it was sold.

All long-term care insurance policies purchased on or after January 1, 1997 are subject to certain requirements and their services must meet specific standards in order to be qualified services.

**2. *Deductibility of Premiums***

If a long-term care insurance policy is qualified, then the premiums paid for such policy are generally deductible as a medical expense so long as the premiums, combined with all other medical expenses, exceed 7.5% of the policy holder's adjusted gross income. The deductibility of premiums is limited to a certain dollar amount, which amount varies depending on the age of the policy holder at the end of the year. The deductibility amounts for

the year 2004 are as follows: <sup>7</sup>.

Age Before Close of Tax Year	Limitation on Deductible Premiums in 2004
40 or under	\$260
41-50	\$490
51-60	\$980
61-70	\$2,600
71 or older	\$3,250

If one's medical expenses, including long-term care insurance premiums, do not exceed this 7.5% floor, then he or she may not deduct the cost of premiums paid on the policy.

If an employer is providing its employees with long-term care insurance, then the cost of setting up the plan, as well as the employer's contribution to the premium, whether in whole or in part, are deductible by the employer as a business expense and are excluded from the employee's taxable income.

---

<sup>7</sup> I.R.C. §§ 213(d)(1)(D), 213(d)(10).

### **3. Non-taxation of Benefits**

The benefits of a long-term care insurance policy are generally not taxable income to the beneficiary if the policy is a qualified long-term care insurance policy.

## **VII. OVERVIEW OF ESTATE TAXES**

### **A. UNIFIED CREDIT**

The *Economic Growth and Tax Relief Reconciliation Act of 2001*, signed by President Bush, regulates both the tax rate and the exemption equivalents through the year 2010. In the year 2010, estates will be free of any federal estate taxation. The chart below demonstrates the tax rate and exemption equivalent corresponding to each year (beginning in 2004 and

ending in 2010): <sup>8</sup>

Tax Year	Tax Rate	Exemption Equivalent
2004	48%	\$1,500,000
2005	47%	\$1,500,000
2006	46%	\$2,000,000
2007	45%	\$2,000,000
2008	45%	\$2,000,000
2009	45%	\$3,500,000
2010	N/A	N/A

The exemption equivalent, or unified credit, is applied towards the cumulative total of taxable gifts made during life and transfers at death. If this cumulative total is no more than the unified credit for the applicable year, then the estate will be free of any federal estate taxation. However, if the cumulative total of taxable gifts made during life and transfers at death exceeds the applicable unified

<sup>8</sup> 26 U.S.C. §§ 2001(c)(2)(B), 2010(c)(2004).

credit, then the amount by which the value of the estate exceeds the maximum exemption equivalent will be subject to federal estate taxation. This amount will be taxed at the rate corresponding to the applicable year.

Example: If John Doe made \$250,000 worth of taxable gifts during his lifetime and his estate is valued at \$1,750,000 at the time of his death in 2005, then his cumulative transfers, during life and at death, exceed the exemption equivalent for the year 2005 by \$500,000 ( $\$250,000 + \$1,750,000 - \$1,500,000 = \$500,000$ ). The first \$1,500,000 will be free from federal estate taxation, while the \$500,000 in excess of the exemption equivalent will be taxed at a rate of 47%.

#### **B. TAX-FREE TRANSFERS**

Certain transfers are free of estate tax and therefore do not count towards the maximum exemption equivalent. A spouse can transfer, by gift or by

bequest, any amount to his or her spouse, so long as both spouses are United States citizens, and that amount, even if it exceeds the maximum exemption equivalent, is not subject to federal estate taxation. In addition, gifts and bequests made to qualified charities are not taxed.

### C. GIFTS

Certain gifts made by an individual during his or her lifetime are not subject to federal estate taxation. There is currently an annual \$11,000 limit, known as the annual exclusion, on the amount of gifts that each donor may make to each person, the donee. If gift(s) from the donor to the donee exceed \$11,000 during a year, then the gift(s) must be reported to the IRS by filing a gift tax return. However, the donor may gift up to, but not exceeding the annual exclusion amount, to as many donees as he or she chooses each year and the gift(s) will be excluded from the aforementioned gift tax reporting requirement. In addition, if the donor is married, his or her spouse may duplicate the gift, such that

the annual exclusion amount is currently increased to \$22,000 per donor and his or her spouse, per donee.

Although gifts are not taxable income to the donee, any future earnings derived from the property are treated as taxable income to the donee.