

The Impact of the Deficit Reduction Act on the Use of Annuities

The use of annuities in Medicaid planning has grown in recent years, especially since the passage of the Deficit Reduction Act in 2005. In order for the purchase of an annuity to qualify as an effective transfer of assets, however, certain requirements must be met.

One requirement is that the annuity must be “actuarially sound”. That means the expected return of the annuity is equal to a reasonable estimate of the beneficiary’s life expectancy. To make this determination, the life expectancy tables published by the Office of the Actuary of the Social Security Administration are used. The tables may be accessed at <http://www.ssa.gov/OAC/STATS/table4c6.html>.

The annuity must also be irrevocable and non-assignable so that it is not considered an available resource. Of course, payment from the annuity is counted as income to the recipient.

The Deficit Reduction Act added new requirements regarding the purchase of annuities. According to the DRA, the purchase of an annuity will be considered the disposal of an asset for less than fair market value, unless:

1. The State (Commonwealth) is named as the remainder beneficiary in the first position for at least the total amount of the medical assistance paid on behalf of the institutionalized individual; or
2. The State (Commonwealth) is named as such a beneficiary in the second position after the community spouse or minor or disabled child and is named in the first position if the spouse or a representative of the child disposes of the remainder for less than

fair market value.

The use of an annuity for a single individual about to enter a nursing home is not very practical and there are other planning strategies that would be more worthwhile. However, using annuities plays a much greater role for married couples.

One method for a husband and wife is for the spouse that is/may be institutionalized to purchase the annuity. This approach is really only beneficial to spouses that have low incomes, as the income stream from the annuity can help the healthy spouse avoid impoverishment.

The more practical alternative would be to have the healthy spouse purchase the annuity. The DRA would appear to allow that spouse to purchase the annuity free of any ineligibility period as long as the state is named as a remainder beneficiary to the extent of any assistance paid on behalf of the "institutionalized individual."

While the use of an annuity in this regard appears to be accepted by the DRA, it appears that the Pennsylvania Department of Public Welfare is, at the present time, challenging the legitimacy of this approach. In other words, using an annuity as a means of Medicaid planning carries the real risk that the application for benefits will be initially denied. The reasons given by DPW for contesting the use of annuities are, at the present time, contrary to guidance given by the Centers for Medicare and Medicaid Services, the federal organization charged with administering the Medicaid program, as well as current case law. The United States District Court for the Middle District of Pennsylvania (a federal court), recently invalidated two arguments that DPW had been making to disallow the use of annuities. In James v. Richman, ___ F. Supp.

, 2006, the Court determined that DPW cannot claim that an annuity is a countable resource because it is marketable on the secondary financial market. The Court also determined that DPW cannot argue that the income stream from an annuity is a countable resource. The James case is currently on appeal to the Third Circuit Court of Appeals.

There are some other restrictions imposed by the DRA regarding the purchase of an annuity by the individual intending to apply for Medicaid benefits. According to the interpretation of the statutes by CMS, an annuity will not be treated as a transfer of assets if:

1. It is considered either an individual retirement annuity (according to Sec. 408(b) of the Internal revenue Code of 1986, or it is deemed an Individual Retirement Account under a qualified employer plan according to Section 408(q), or
2. The annuity is purchased with the proceeds from a traditional IRA, certain accounts or trusts which are treated as traditional IRAs, a simplified retirement account, a simplified employee pension, or a Roth IRA, or
3. The annuity is irrevocable, non-assignable and is actuarially sound and provides payments in approximately equal amounts with no deferred or balloon payments.