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Elder Law: Annuity valuable option in a crisis

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Many of our clients come to us owning a variety of asset types. From real estate to CDs, stocks, bonds, mutual funds and annuities, each of these assets has different characteristics and purposes. Each type of asset also presents different challenges when dealing with long-term care planning issues, such as paying for an expensive care facility or a private caregiver at home.

While many asset types have been around for decades in one form or another, annuities seem to present many more complex questions for clients, especially in light of more recently enacted federal and state medicaid laws and the ensuing landmark cases in the Pennsylvania Commonwealth Court and Federal Courts.

Before discussing the potential usefulness of annuities in long-term care planning, it is important to recognize the basic attributes of this type of investment. There are many types of annuities, and they go by different names, depending on the insurance carrier. But, basically, the annuity is an investment contract by which the purchaser (usually the owner of the contract who is also the person to receive the income from the annuity) purchases an annuity contract from an insurance company.

There are two main annuity types for our discussion: Deferred (for longer term investment purposes) and Immediate (for "immediate" income), or a combination of both types. On the investment side, the investor may purchase the annuity to provide either a fixed or variable rate of return on the investment, along with a host of "add on" options (and costs) to enhance the product. On the income or immediate side, the investor may purchase the product in exchange for a guaranteed stream of income payments for a fixed time period or for life. While there are numerous variations, these are the most common types.

So how can this investment tool be used in long-term care planning, and when is it appropriate? While there are many reasons to buy (or not buy) an annuity, we will focus only on the use of the "income" type of annuity for people who are seeking eligibility for Medicaid long-term care coverage. This focus is typically in a nursing home situation where the nursing home resident is facing long-term care costs that can approach $100,000 a year. (Recall from some of our previous articles that, in Pennsylvania, the current average cost of nursing home care is $97,346 a year based upon the state's data.)

Given these staggering costs, many people seek to expedite their eligibility for Medicaid to cover their long-term care expenses by legally converting "countable" or "nonexempt" resources used in determining Medical Assistance eligibility (those resources that would normally have to be spent down to near poverty levels) into exempt (noncountable) resources or a stream of "exempt" income. These resources and/or income would then be used, usually to benefit the healthy spouse of a nursing home resident. In this situation, an immediate annuity can be a valuable tool to shelter additional resources that would otherwise face the dreaded "spend down" for Medicaid eligibility.

However, the rules for properly converting countable resources via an annuity have been the subject of significant litigation in Pennsylvania for more than a decade. Under the federal Deficit Reduction Act of 2005, the federal government attempted to clarify the rules for purchasing an annuity to help shelter excess resources.

While this new law (which was then further enacted in Pennsylvania in 2006) did clarify some aspects, there existed several issues and unanswered questions that were recently decided in a series of landmark cases in federal court. Because of these cases, Medicaid applicants and their spouses now have alternatives to "spending down" their life savings in order to qualify for Medicaid. That said, the scenarios for utilizing this option vary and competent legal and financial advice should be sought.

There are specific legal parameters and criteria to establishing a "Medicaid compliant" (this is a term of art) annuity. If each of the criteria is not met, then the purchase of the annuity will fail to shelter the resources as anticipated. Therefore, it is critical to verify through your legal and financial advisers that the annuity will pass the necessary tests.

The decision to purchase a Medicaid compliant annuity typically occurs when a person is in a "crisis mode" dealing with the possibility of an extended and expensive nursing home stay. While the introduction of the Medicaid compliant annuity is not the answer in every case, it provides another option for families to consider when they have not adequately planned in advance.

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