



## **An Agricultural Law Research Note**

### **Should Potential Long-Term Health Care Needs Be a Part of Your Farm Estate Plan?**

by

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### Should Potential Long-Term Health Care Needs Be a Part of Your Farm Estate Plan?

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Long-term health care is becoming an important issue for an increasing number of people. Not only are people living longer than at any time in the past, the cost of long-term care continues to rise. Before 1980, the median age of the population in the United States was 30;<sup>1</sup> estimates are that by 2010 the median age will be 37 – the present median age of Floridians.<sup>2</sup> The fastest growing portion of the population is those over age 65 and, of that group, the segment consisting of those over the age of 85 is growing the fastest. As people grow older, they tend to have more health problems, with some people requiring long-term health care. Consequently, one of the most pressing problems facing a significant portion of the elderly is the cost of long-term health care. 1997 data from the American Health Care Association indicates that the average American male can expect to spend \$56,895 on long-term care and the average woman \$124,370.<sup>3</sup>

In the United States, the average cost of nursing home care is about \$4,000 per month<sup>4</sup> and can exceed \$9,000 each month in Alaska.<sup>5</sup> Thus, a major concern is how to pay for long-term health care and, at the same time, preserve family assets from being depleted.

#### Long-Term Health Care Payment Options

There are various methods of paying for long-term health care. Some people choose to pay the cost out of their own private funds. Others purchase long-term health care insurance. Another option

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<sup>1</sup> Thomas D. Begley & Jo-Anne Herina Jeffreys, REPRESENTING THE ELDERLY CLIENT (2002).

<sup>2</sup> *The Kiplinger Letter*, July 20, 2001, p.1.

<sup>3</sup> The American Care Association Profile, p.1 (Apr. 1997).

<sup>4</sup> CNA Nursing Home Survey, 2000.

<sup>5</sup> *Id.*

is to rely on government benefits such as Medicare, federal or state veterans benefits, and Medicaid to cover some or all of the cost of long-term care.

Private funds. With the average cost of nursing home care approximating \$35,000-\$60,000 per year, a significant number of elderly may not be able to afford to pay for nursing home care with their own funds. Assisted living may be a less expensive option, but it still averages more than \$20,000 annually.<sup>6</sup> Some elderly people may be able to utilize in-home care, in which care is generally viewed as the least costly option, presently running about \$15,000 per year,<sup>7</sup> However, in-home care may not be practical for many elderly.

Qualified long-term care expenses are deductible as itemized deductions to the extent all deductible medical expenses exceed 7.5 percent of the taxpayer's adjusted gross income. Qualified expenses must be (1) incurred for necessary diagnostic, preventative, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal care services; and (2) be required by a chronically ill individual and provided pursuant to a plan of care prescribed by a licensed health care practitioner. An individual is chronically ill if a licensed health care practitioner has certified the individual as either (1) unable, for at least 90 days, to perform at least two activities of daily living without substantial assistance from another individual because of a loss of functional capacity (activities of daily living include eating, toileting, transferring, bathing, dressing and continence) or requiring substantial supervision to be protected from threats and safety because of severe cognitive impairment.

Long-term care insurance. Long-term care insurance can be a viable way of paying the cost of long-term care in the right situation. However, current estimates are that fewer than 10 percent of the elderly are covered by such policies,<sup>8</sup> and estimates are that long-term care insurance will never be a major player in financing the cost of long-term care. Many may not be aware of the availability of long-term care insurance, and some may be living under the assumption that they will never need long-term care or that their children will provide for their care. In addition, the cost of long-term care insurance may be a significant barrier for some, particularly those that are relatively older or have medical problems at the time an attempt is made to acquire coverage.<sup>9</sup> But, while the premiums may

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<sup>6</sup> LifeCare, Inc., Health Insurance Association of America (HIAA), WHO BUYS LONG TERM CARE INSURANCE IN 2000? A DECADE STUDY OF BUYERS AND NON-BUYERS (Oct. 2000).

<sup>7</sup> Citizens for Long Term Care, LONG TERM CARE FINANCING REFORM: AN INTEGRAL PART OF SOCIAL SECURITY AND MEDICARE REFORM (June 2000).

<sup>8</sup> Joshua M. Wiener et al., *Federal and State Initiatives to Jump Start the Market for Private Long-Term Care Insurance*, 8 ELDER L. J. 57 (2000).

<sup>9</sup> The average annual premiums for long-term care policies with a 20-day elimination period and four years of coverage (for just the base plan) are in excess of \$4,500 for an individual age 79 and approximately \$500 for an individual age 50. *Id.* See also Health Insurance Assoc. of America, Long-Term Care Insurance in 2000-2001, <http://membership.hiaa.org/pdfs/policy/030130LTCExecutiveStudy.pdf>.

seem high, they are significantly lower than the cost of any potential long-term care.<sup>10</sup> The cost of a long-term care policy is less the younger the potential insured. At age 65 approximately 25 percent of all applicants for long-term care insurance will be denied due to lack of insurability. So, the sooner the better with respect to checking into the viability of long-term care insurance.

The cost of most long-term care insurance is deductible as a medical expense because the policies are generally treated as if they were accident or health insurance policies.<sup>11</sup> In accordance with Revenue Procedure 2002-70,<sup>12</sup> for taxpayers who itemize their deductions, the deductible portion is tied to the taxpayer's age at the end of the tax year as follows:

Age of Taxpayer at End of Tax Year	Insurance Premium Deduction Limit	
	2003	2003
40 or under	\$240	\$250
41 to 50	450	470
51 to 60	900	940
61 to 70	2,390	2,510
71 or older	2,990	3,130

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**Example:**

Harvey and Hannah are 68 and 60 years old, respectively. They each have a long-term care policy with lifetime benefits. Harvey's premium is \$5,000 annually and Hannah's is \$3,500. They itemize their personal deductions, and have \$6,000 of deductible medical expenses other than the long-term care insurance, which exceeds 7.5 percent of their adjusted gross income. For 2002, \$2,390 of the premium on Harvey's policy is deductible, but only \$900 of the premium on Hannah's policy is deductible. The total deductible amount attributable to their policies is, therefore, \$3,290. The actual benefit of the deduction to Harvey and Hannah will depend on their tax bracket.

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<sup>10</sup> Many long-term care policies are guaranteed renewable, which means coverage cannot be canceled by an insurance company, nor can premiums be raised on an individual basis because of increasing age or declining health. In general, premiums on this type of policy can only be raised on a class basis that affects all policyholders with that particular insurance company in that class, and then only with the approval of the state insurance commissioner.

<sup>11</sup> To be deductible as a medical expense, a long-term care insurance policy must be guaranteed renewable; not provide for a cash surrender value or other money that can be paid, assigned, pledged or borrowed; provide that refunds, other than refunds on the death to the insured or complete surrender or cancellation, and dividends under the contract must be used only to reduce future premiums or increase future benefits; and not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses. I.R.C. §7702B(b).

<sup>12</sup> I.R.B. 2002-46.

Qualified long-term care expenses not covered by insurance are deductible as itemized medical expense deductions. Also, if a long-term care policy pays for nonmedical costs, the costs for these services in excess of the insurance coverage is not deductible.<sup>13</sup> Likewise, if the reason for being in a long-term care facility is personal, then the cost of meals and lodging paid by the taxpayer above the amount the insurance pays is not a deductible medical expense.

Medicare. Medicare is a federal insurance program that provides medical benefits for the elderly and the disabled.<sup>14</sup> Medicare Part A covers hospital and skilled nursing facility care. No premium is required for Part A from persons entitled to receive retirement or disability benefits from Social Security. Persons age 65 or older who do not qualify for Social Security can obtain Part A coverage by paying a premium and enrolling in Medicare Part B, which pays for physicians. To be eligible for nursing home coverage under Part A, a patient must be hospitalized for a period of at least three days under a stay covered by Medicare and must be discharged from the hospital into the nursing home within 30 days after hospital discharge. Also, a physician must certify that the medical care is needed and the patient must require daily skilled nursing or skilled rehabilitation services that can only be provided at a skilled nursing facility on an inpatient basis for treatment of a condition for which the patient was hospitalized. For skilled care received in a nursing home, Medicare provides coverage for up to 100 days during a spell of illness. The first 20 days are paid in full. Thereafter, the patient has a co-payment of \$101.50 a day for 2002 for days 21 through 100, with Medicare paying the difference. After day 100, Medicare does not provide coverage.<sup>15</sup>

Medicare provides minimal coverage for home care and no coverage for assisted living, except to the extent that the facility provides skilled care through a third-party provider.

Veterans Administration. The United States Veterans Administration (VA) owns and operates approximately 115 nursing facilities, with the VA providing either “skilled” or “intermediate” care in those facilities. The Veterans Millennium Health Care and Benefits Act<sup>16</sup> requires that nursing home care be provided to (1) any Veteran requiring nursing home care for a service-connected disability; and (2) any Veteran with a service-connected disability rated at 70 percent disabling or above. Nursing home care is provided to other Veterans on a “space available” basis.

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<sup>13</sup> In addition, beginning in 2003, sole proprietors, partners, 2 percent and greater shareholders of S-corporations and LLC members will be able to deduct 100 percent of the eligible long-term care premium. Also, beginning in 2003, benefits paid on a qualified long-term care insurance policy to an individual are not taxable income as long as benefit payments above \$220 per day do not exceed the actual cost of care.

<sup>14</sup> 42 U.S.C. §§1395-1395xx.

<sup>15</sup> Current estimates are that Medicare pays approximately 25 percent of all nursing home bills. See *supra*, note 1, at §1.02[B][1].

<sup>16</sup> 38 U.S.C. §1710A.

Medicaid. Medicaid is a federal-state program of medical assistance for low-income individuals who are aged, blind or disabled.<sup>17</sup> Medicaid covers most of the costs of long-term nursing home care after the patient (and spouse) exhausts financial resources.<sup>18</sup> Consequently, if an individual's estate planning objective is to preserve assets for the family, estate planning in the Medicaid context typically involves a combination of converting assets and resources that would be counted toward Medicaid eligibility (and subject to depletion) to non-countable assets, spending down resources, and transferring assets to other family members either outright or via trust.<sup>19</sup>

To be eligible for Medicaid in many states, an individual must reduce his or her share of countable assets to approximately \$2,000. Resources exempt from the Medicaid eligibility calculation include (1) one automobile if used by the individual or a member of the family for employment or medical transportation or transportation of a handicapped person (otherwise, only \$4,500 of the value of the automobile is excluded from the resource limit); (2) the home, if the applicant plans to return home; (3) property used in a trade or business;<sup>20</sup> (4) property used for self-support or employment; (5) personal effects and household goods up to \$2,000; (6) wedding and engagement rings, medical devices, life insurance with a total face value of \$1,500 or less, or term insurance regardless of face value; and (7) certain income-producing property.<sup>21</sup> Whether or not a retirement account or IRA is a countable asset varies from jurisdiction to jurisdiction. All income, including Social Security and pension income, is paid to the nursing home. The Medicaid recipient is entitled to a personal needs allowance of \$30-\$60 dollars per month. A spouse of a Medicaid recipient (known as the community spouse) is entitled to keep one-half of the couple's countable assets up to \$90,660 for 2003,<sup>22</sup> and is entitled to a minimum monthly income of \$1,493 through June 30, 2003, and \$1,515 effective July 1, 2003.<sup>23</sup>

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<sup>17</sup> 42 U.S.C. §1396.

<sup>18</sup> Medicaid currently pays in excess of 60 percent of all nursing home and assisted living costs, and about 40% of all long-term care costs. *See supra*. note 1 at Chapter 7.

<sup>19</sup> For a detailed discussion of long-term health care planning techniques involving Medicaid, see Roger A. McEowen & Neil E. Harl, *Estate Planning for the Elderly and Disabled: Organizing the Estate to Qualify for Federal Medical Extended Care Assistance*, 24 IND. L. REV. 1379 (1991); Roger A. McEowen, *Estate Planning For Farm and Ranch Families Facing Long-Term Health Care*, 73 NEB. L. REV. 104 (1994).

<sup>20</sup> The line between investment assets and trade or business assets in a setting of lease of farm or ranch property is unclear.

<sup>21</sup> A complete list of noncountable assets is contained at 42 U.S.C. §1382b.

<sup>22</sup> 42 U.S.C. §1396r-5(c)(1)(A)(ii).

<sup>23</sup> The amount is pegged at 150 percent of the monthly poverty guideline for a couple. 42 U.S.C. 1396r-5(d)(3)(B)(i)-(iii). The present poverty rate can be found at 68 Fed. Reg. 6456-6458 (Feb. 7, 2003). Also, the resource allowance minimum is \$18,132 for 2003, and the maximum income allowance is \$2,267 (for 2003).

**Example:**

John Smith is 70 years old and has recently entered a nursing home. He receives \$1,100 per month in Social Security benefits and Mary, his wife who remains at home, receives \$600 per month in Social Security benefits. John and Mary jointly own their home, an automobile, a \$50,000 C.D. and have an \$800 balance in their checking account. John applies for Medicaid benefits. Both a resource determination and income determination will have to be made.

**Resource Determination.** John and Mary's home and automobile are exempt resources (non-countable assets), but the C.D. and the balance in the checking account are available resources for Medicaid eligibility purposes. The total of the available resources is \$50,800, and one-half of that amount is \$25,400. Thus, \$25,400 will be allocated to Mary, and \$25,400 will be deemed available to John for Medicaid eligibility purposes. John will not be eligible for Medicaid benefits until he spends his \$25,400 share down to \$2,000.

**Income Determination.** When John becomes eligible for Medicaid, an income allowance will be calculated. John and Mary have a total monthly income of \$1,700, \$1,493 of which can be preserved for Mary. Thus, Mary would be entitled to her \$600 monthly Social Security benefits plus an additional \$893 of John's monthly Social Security benefits. The remainder of John's income, \$207, would have to be spent on his nursing home care with Medicaid covering the balance.

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## **Medicaid Planning – Policy and Ethical Concerns**

Some people struggle with the idea of transferring assets to other family members with the intent of protecting those assets against depletion paying for long-term health care when sufficient wealth is present to cover the cost of care. Present law permits outright transfers made more than three years before an application for Medicaid is made.<sup>24</sup> In other words, at the time a Medicaid application is made, the value of all uncompensated asset transfers made within the previous three years is deemed available to the Medicaid applicant for eligibility purposes. Transfers in trust are subject to a five-year "look-back" period.<sup>25</sup> So, one planning option is to set aside enough funds to pay the nursing home bill for three (or five) years, transfer assets to start the "look-back" period running, and then make a Medicaid application after the three (or five) year window has expired. Thus, it is possible, with proper planning, to preserve wealth for the family and, over time, achieve Medicaid eligibility.<sup>26</sup>

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<sup>24</sup> 42 U.S.C. §1396p(c)(1)(A).

<sup>25</sup> 42 U.S.C. §1396p(c)(1).

<sup>26</sup> The federal gift tax and carry-over basis for gifted assets in the hands of donees provides a tax disincentive to transfer assets for Medicaid eligibility purposes. For those that have achieved their wealth through asset appreciation, the tax cost of making gifts could outweigh the benefit of utilizing Medicaid to pay for long-term health care.

While the legality of certain asset transfers doesn't solve the ethical question many face, the reality is that many people who can afford to pay for their own long-term care choose to do so.<sup>27</sup>

## Conclusion

Long-term health care planning should be considered an important part of the overall family estate plan. This is particularly true if an objective of the family estate plan is to accomplish an intergenerational transfer of wealth to subsequent generations. Clearly, earlier planning for long-term health care provides more options for the family.

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<sup>27</sup> It is interesting to note that a major issue presently before the Congress is an attempt to make the one-year repeal of the federal estate tax (in 2010) permanent. Such a move would enable the very wealthy to pass their entire estates to their children tax-free, with the cost of repeal being borne largely by those that would not benefit from repeal because their estates are not of sufficient size to be subject to federal estate tax.