Understanding Medicaid Asset Protection Trusts

The prospect of paying for long-term health care can be scary. Consider the numbers: The median annual cost for a private room in an assisted living facility was $54,000 in 2021, and a private room in a nursing home cost more than $108,000. An American turning 65 today has nearly a 70% chance of needing some type of long-term care services in their remaining years, so it's understandable why planning for these expenses can elicit fear and anxiety.

Typically, planning for long-term care requires thoughtful timing and prioritization: Because of competing financial priorities (such as funding retirement or a child's education), long-term care planning is put off until it has become too late to implement strategies effectively. For example, the cost of long-term care increases as we age, as does our likelihood to experience a medical event requiring long-term care. As a result, families can become overwhelmed when a long-term care event does occur.

Financial planners and attorneys may suggest that a family look into establishing a "Medicaid trust." There are several different types of Medicaid trusts, but they all share a common objective of preserving family assets while leveraging state and federal resources to pay for long-term care expenses. In some cases, these trusts may be appropriate; however, families should carefully consider all available planning options before making the decision to irrevocably transfer assets to such a trust.

Who qualifies for Medicaid long-term care coverage?

Unlike Medicare, which is a federal entitlement program, Medicaid is a means-tested program that is available only to those applicants who meet both medical and financial criteria. It is a joint federal and state program; in addition to the applicable federal regulations, each state also has its own set of rules and regulations. Medicaid provides many different types of benefits, including health insurance expenses and long-term care expenses, for those who would otherwise be unable to afford them.

When it comes to long-term care, Medicaid eligibility depends on both the applicant's income and assets, as well as assets an applicant may own with their spouse. For 2023, a single individual 65 years or older must have less than $2,742 in income per month to qualify for basic Medicaid health care. To qualify for long-term care from Medicaid, a single individual 65 years or older must have $2,000 or less in countable assets in most states.

Countable assets vary from state to state but typically include bank accounts, certificates of deposit, life insurance policies with a face value that exceeds the exemption limit of your state, stocks, bonds, and property that is neither rented nor your primary home. Exempt, or non-countable, assets typically include your primary residence, most personal property, home improvements, and pre-paid funeral and burial expenses. Properly drafted irrevocable trusts are typically exempt, which can make them a planning option for people looking to reduce their countable assets and qualify for long-term care coverage through Medicaid. However, it's important to note that states are required to recover certain Medicaid benefits paid on behalf of a Medicare enrollee when they pass away, and could place a lien on an enrollee's property at that time, forcing the estate to sell the property in order to satisfy the lien (unless a surviving spouse, a child under 21, or a disabled child of any age resides there).

The downside of using an irrevocable trust

Irrevocable trusts typically can't be altered after they have been established, and the person who creates the trust (the grantor) does not generally have access to its assets. Medicaid Asset Protection Trusts (MAPTs) are irrevocable trusts specifically designed to preserve as much of a family's assets while maximizing an applicant's chances of qualifying for Medicaid.

There are trade-offs to this strategy. The grantor must relinquish control over the assets. Typically, neither the grantor nor their spouse can serve as trustee. And the grantor and their spouses' access to trust principal is limited. The grantor may have access to trust income, although that income may be a countable resource for Medicaid eligibility.

"To be effective, transferring money into a MAPT should be carefully coordinated with the attorney that drafts the trust for you," says Kerry Beeber, a vice president on Fidelity's advanced planning team. She cautions, however, that people should be mindful of 4 potential pitfalls:

1. **The Medicaid "look-back" period.** Under current law, this provision allows the government to treat any assets that were given away, transferred, or sold for less than their fair market value in the 5 years preceding the date someone applies for Medicaid as countable assets. (In California, the look-back period is currently 2.5 years.) For those looking to establish Medicaid long-term care eligibility in the short term, the look-back period is a major obstacle.
2. **Transferring retirement assets into a MAPT.** This can have significant income tax repercussions, even if they qualify for distributions. "When clients ask me if they should cash out their IRA to help qualify for Medicaid, I explain the potential tax implications and urge them to speak with their attorney or accountant before making any decisions," Beeber says. "It's typically not the best course of action."
3. **The inflexibility of irrevocable trusts.** Such trusts make it challenging to adapt to changing circumstances. For example, your monthly income might increase enough that you no longer qualify for Medicaid, but because you transferred assets to the irrevocable trust, you would have lost the ability to access them. Alternatively, you might encounter another big expense and struggle to pay for it after relinquishing your assets to the trust.
4. **Changing laws and regulations.** It's possible that at some point in the future, the laws governing both Medicaid and MAPTs might change and disrupt your plans. States are continuing to challenge the enforceability of Medicaid trusts, and depending on the outcome of these disputes, you may be affected. The rules on who qualifies for Medicaid could also change, perhaps leaving you ineligible.

Setting up an irrevocable trust to qualify for Medicaid long-term care can dramatically alter your overall long-term financial plan. Long-term care is a significant expense for many people, but the amount spent on it varies dramatically from person to person, and it's just one of many expenses to plan for. Your financial professional can help you create a well-rounded strategy that accounts for the possibility of long-term care expenses while also helping you maintain your lifestyle and cover other major costs.

Insurance may offer more flexibility

For many people, it may make more sense to invest in long-term care insurance. There options to choose from. With traditional long-term care insurance, you can choose the amount of coverage, the length of the coverage, and the amount of time you must wait before receiving benefits.

Planning for a long-term care event can be a complicated exercise, but families cannot overlook the possibility, if not likelihood, that a parent or spouse will require long-term care. For most people, the place to start is working with a financial professional to evaluate the health of their financial plan, and stress test that plan with the expense of a long-term care event.

Living in a Welfare-run Nursing Home should not be your goal.

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