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REAL ESTATE, TRUSTS & ESTATES, BUSINESS PRACTICE GROUPS ▪ when it really matters

UNDERSTANDING THE HARSHEST CUTS IN MEDICAID

Ilene D. Samuel, Esq.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005 ("DRA") into law. The DRA inflicts the harshest cuts in Medicaid ever made and has made it far more difficult for persons to become eligible for institutional Medicaid. This article, which focuses on institutional Medicaid and not home aid or assistance, discusses the changes to the law which became effective on February 8, 2006, the date that the bill was signed into law.

The Look Back Period - Under the new law, the look back period to determine whether an individual disposed of assets for less than fair market value, i.e., gifts, is sixty (60) months for all transfers, whether such transfers be to an individual or to a trust. For practical purposes, however, until February 8, 2009, the look back period for non-trust asset transfers is thirty-six (36) months – the rule under the old law, and after February 8, 2009 until February 8, 2011, the look back period will increase by one month for each month that has elapsed. Therefore, application of the five (5) year look back period will not effectively apply until February 8, 2011.

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The Penalty Period

The transfer of assets within a look back period creates a penalty period. This is a period of months during which the transferor will not be eligible for Medicaid. Therefore, if during the penalty period the individual requires institutional care, the individual, or most probably family members, will have to privately pay or at least provide care and support for the applicant until the penalty period expires.

The penalty period is calculated by dividing the amount of uncompensated transfers by the average monthly cost of nursing home care in the Medicaid applicant's geographic area. The more assets that are transferred, the longer the resulting penalty period. For example, if an applicant transfers $150,000 to his son on February 9, 2006, and if the average monthly cost of nursing home care is $9,842, then the penalty period would be 15.24 months ($150,000 divided by $9,842).

The penalty period begins to run from the date on which, except for the penalty period, the individual would otherwise be eligible for Medicaid assistance based on an approved application for such care. This means the penalty period begins when an applicant has $4,150 or less of assets in his or her name. The reader will note that in the foregoing example the 15.24 penalty period does not begin to run until the applicant's funds have essentially run out. However, the DRA contains a hardship provision that permits the applicant to obtain institutional Medicaid if the penalty period would deprive the applicant of medical care that would endanger his or her life or health or deprive the applicant of food, clothing or shelter.

Exempt Transfers

Certain transfers are exempt from the penalty period. With respect to a home, no penalty period will be assessed if the home is transferred to the individual's spouse, minor child, disabled or blind child or, subject to certain conditions, an adult caretaker child or a sibling. The transfer of assets other than the home are exempt from the penalty period if the assets were transferred to or for the benefit of the individual's spouse or blind or disabled child or to a trust for the sole benefit of the individual's spouse, child or a disabled individual under 65.

The Family Home

The applicant can retain his residence and qualify for Medicaid if the applicant signs a statement of an "intent to return home". However, even if there is a subjective intent to return home, a lien may be imposed on the residence for the cost of the institutional care if the person is perma-

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YOUR LEASE CAN SAVE YOUR COMPANY'S LIFE

Jane M. Myers, Esq.

Within the past three years, low interest rates and a blizzard of real estate activity made economic growth and vitality seem to be a sure bet. As a result, many business owners gambled that their businesses would expand along with the growing economy. Companies frequently took a leap of faith and leased far more space then they ordinarily would have to meet projected growth. For some, the gamble paid off, but for others it did not.

Economic Growth

Rent and payroll are the biggest overhead expense for any company. While the solution to reducing payroll is obvious and simple, the solution to reducing rent may not be easy if not planned in advance. What then should a lease contain to protect a business owner in times of growth as well as in times of economic uncertainty?

In an ideal world, to avoid the time, expense and inconvenience of relocation, the well-informed business owner would have negotiated a lease that anticipates both business expansion and contraction. To accommodate expansion, the lease should contain such provisions as an option to lease additional space as it becomes available in the building, an option to extend the lease term, and perhaps an option to purchase the building.

To hedge against a downward economic cycle, the lease should contain provisions such as the right to assign the lease and the right to sublet all or a portion of the space to another tenant. In addition, careful attention should be paid to the "use" clause that appears at the beginning of most commercial leases to ensure that the stated "use" will not limit the tenant's choice of prospective substitute tenants. Instead of limiting the use of the premises to a specific type of business, such as law, architecture, insurance, or the like, it is better to include broader language, such as "general administrative offices" to broaden the prospective tenant pool should a company need to cut costs and rent part or all of its space.

Rights to Lease and Sublease

The right to assign a lease and the right to sublet all or a portion of the space create very different rights and relationships between the landlord and the original tenant. An assignment of lease transfers to a new tenant the right to occupy the premises for the entire balance of the lease term. The new tenant has a direct relationship with the landlord and pays rent directly to the landlord. In effect, the new tenant becomes the "tenant" under the lease in place of the original tenant.

How Subleases Work

A sublease is for less than the remaining term of the lease and can be for all or part of the premises. Under a sublease, the new tenant does not have a direct relationship with the landlord. When there is excess space on the market, a sublease arrangement can be attractive for a subtenant since typically the rent paid by the subtenant will be considerably less than the rent owed by the original tenant under the prime lease. The new tenant pays the rent it agreed to pay under the sublease to the original tenant who, in turn, remits that amount to the landlord and pays the deficiency so that the landlord receives the full rent stated in the prime lease.

Under a sublease arrangement, the original tenant becomes the landlord or "sublessor" to the subtenant. However, the original tenant, as the sublessor, will certainly not want to assume the landlord's responsibilities under the prime lease for maintenance and repairs; instead, the sublease should include language to the effect that the sublessor has no obligation for maintenance and repairs, but will take steps necessary to compel the landlord to fulfill its lease obligations under the prime lease.

In both the assignment and sublease scenarios, it is critical to note that even if the landlord consents to accept the proposed new tenant, that does not mean that the original tenant is automatically released from liability under the prime lease. The original tenant will remain liable on the prime lease and the landlord can look to recover damages from the original tenant if the new tenant defaults, unless the tenant is able to negotiate a release from its lease obligations.

A sublease poses substantial risk to a subtenant. The rights of the subtenant under the sublease are completely dependent on the existence of the prime lease between the landlord and the sublessor. Since the subtenant has no contractual relationship with the landlord, once the term of the prime lease ends or if the sublessor defaults and the prime lease is terminated, the sublessee's right to occupy the premises is terminated.

Sublease Cautions

Because of the tenuous nature of a sublease, a subtenant would be prudent to condition the sublease upon the sublessor obtaining a separate document signed by the landlord called a non-disturbance agreement. Such an agreement would provide that if the sublessor defaults under the prime lease, the landlord agrees that it will not evict the subtenant. Instead, the subtenant will be deemed the "tenant" under the prime lease or the landlord will agree to enter into a new lease directly with the subtenant.

The assignment/sublet provision of a business lease may prove to be a business owner's life preserver when anticipated economic conditions are reversed.

For almost a quarter century LBC&C has built its reputation as one of the most skillful and successful law firms in the metropolitan area offering a complete spectrum of legal services encompassing every aspect of the law. As a full service law firm with a staff of over 100, LBC&C provides legal counseling, as well as litigation services for clients from business issues to employment and labor practices. Always on the alert to new trends in business and changes in the law, LBC&C is continuously striving to keep clients ahead of their competitors. Working in conjunction with each other, the Practice Groups at LBC&C provide a network of legal experience that is unrivaled. For additional information visit our website at www.lbcclaw.com

nently absent and not expected to be discharged from the nursing home.

If an individual owns an equity interest of more than $500,000 in their residence ($750,000 in New York), the home will be treated as an available resource despite an intent to return home. However, home equity is defined as the market value of the home minus any mortgage. Therefore, a mortgage or home equity loan will reduce the equity value in the residence. Moreover, this home equity cap does not apply to a residence in which the individual's spouse or minor or disabled child is residing.

Annuities

Purchasing an annuity is not a "transfer of assets" and does not create a penalty period. (An annuity is a contract by which one receives fixed payments on an investment for a lifetime or for a specified number of years.) However, certain rules apply to annuities. Unless the beneficiary is the spouse or a minor or disabled child, the state must be the primary beneficiary to pay back to Medicaid sums paid by it on behalf of the applicant, and if there is a spouse or a minor or disabled child, then the state must be named as the secondary beneficiary.

Conclusion

As stated, if an applicant runs out of funds and applies for Medicaid during the look back period, the penalty period, if any, will extend the applicant's period of ineligibility for Medicaid. Therefore, extreme care must be exercised as to when to apply for institutional Medicaid since it may be better to allow the look back period to expire rather than to apply for Medicaid during the look back period and thereby add a penalty period that which will extend beyond the expiration of the look back period.

In the light of recent Medicaid eligibility changes, the ideal situation is for a client to transfer assets far in advance and before the need for nursing home care is imminent. Of course, long term care insurance is perhaps more important than ever. Moreover, this article is a brief explanation of a highly complex law and an elder law attorney should be consulted when attempting to deal with it.

THE LATEST . . .

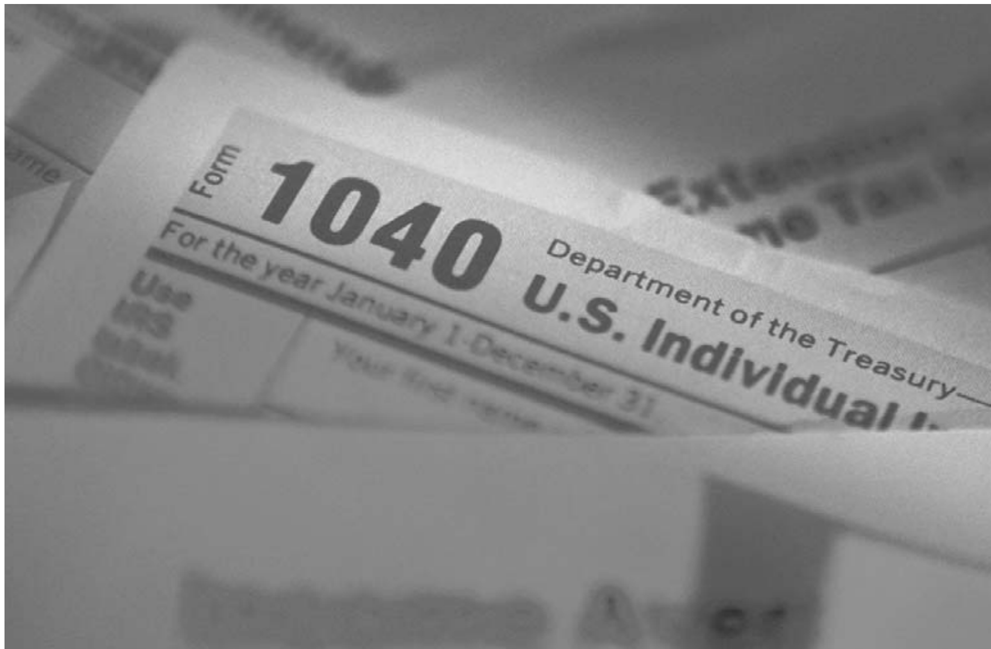
What's happening at LBC&C

- Marian Rice appeared on "Law You Should Know" on WHPC 90.3 FM discussing law managment issues and was a guest lecturer at CUNY law school class on avoiding malpractice claims. Marian is also speaking at the ABA Standing Committee on Professional Liability Fall Conference in Chicago; chairing and speaking at two NYSBA seminars (NYC and Buffalo) on Don't Make Malpractice Your Nightmare; and presented a program on Improving Client Communications for the SCBA. She also recently received the Director's Award from the NCBA Board of Directors for work as outgoing Chair of the Long Range Planning Committee.
- Deborah S. Barcham was appointed to the Advisory Council for the Nassau Academy of Law of the Nassau County Bar Association. She was also appointed Focus Editor for the special Trusts & Estates issue of The Nassau Lawyer - 2/2007
- Ilene D. Samuel was appointed Vice Chair of the Tax Law Committee of the Nassau County Bar Association.

LIFE INSURANCE...AVOIDING THE ESTATE TAX PITFALLS

Deborah S. Barcham, J.D., L.L.M.

We, as consumers, are bombarded constantly with advertisements extolling the benefits of life insurance and how we have an obligation to take steps to protect our family's future from the unexpected loss of a loved one. Clever advertising leads us to envision scenes of our children not being able to go to college, or our spouse not having enough funds to remain in the family home or other dire situations and thus we succumb to the pressure and purchase life insurance policies without being aware of some fairly simple estate tax techniques that can make a significant difference in the amount of the insurance proceeds that our family will actually realize on our death.



Benefits of Life Insurance

It is true that life insurance is a very cost effective method of providing economic security for a family in the event of the death of one of the principal wage earners, for one spouse on the death of another or for paying off debts, such as mortgages, upon death. It can also be a very useful tool to ensure that sufficient cash (liquidity) will be available when estate taxes are due so that the estate will not be forced to sell other valuable assets, which the estate may not wish to sell or for which the timing may be inopportune. The proceeds of a life insurance death policy are payable immediately in cash and pass to the beneficiaries income tax free. Life insurance proceeds avoid probate unless the estate or a trust under the will is the beneficiary.

Life Insurance and the IRS

However, the proceeds from life insurance are subject to estate tax if you own the policy or have rights in the policy (what the IRS calls "incidents of ownership"). Unfortunately, a substantial portion of the policies issued are owned by the insured and thus are includible in his or her estate, which can result increasing the value of the estate and in potentially losing up to half the insurance proceeds to estate taxes. Thus the funds that a parent thought would go to fund his children's college education, provide for his spouse's future security on his death or provide cash for the payment of estate taxes in lieu of selling valuable estate assets could be cut in half due to the failure to institute some simple estate planning strategies.

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To avoid increasing your estate tax liability with the very method you choose to pay it with, you could implement one of the following techniques:

1. Create an irrevocable life insurance trust and have the trustee purchase and own the life insurance policy. If you already have an existing policy or policies you can transfer them to a newly created life insurance trust, however there will be a three (3) waiting period from the date of transfer before the proceeds will be free from estate tax. The trustee will be obligated to pay the policy premiums and you will be able to gift the amount of the premiums to the trust annually using your and your spouse's annual gift tax exclusion, provided you give notice of such contributions to the trust beneficiaries and a right to withdraw such contributions for a period of time (Crummy notices).
2. Have your children over age eighteen (18) purchase and own the policy. They can pay the premiums with gifts that you and your spouse may give them each year under the $12,000 annual gift tax exclusion.

Using an irrevocable life insurance trust is among the most common estate planning strategies used today. As long as the trust is properly drafted, administered and funded, the insurance proceeds can be received free of estate tax. In addition, the policy proceeds can be held in trust for the life of the surviving spouse and on his or her death distributed to the children or held in further trust for the children. If held in trust for the spouse's life, the proceeds will also not be taxed in the surviving spouse's estate on his or her death. The liquidity the proceeds provide can help ensure that your assets are preserved for distribution, especially if your estate contains illiquid assets such as a family owned or closely held business or real estate.

BE CAREFUL WITH INDEPENDENT CONTRACTORS

Jane M. Myers, Esq.

Employers sometimes look to categorize certain types of help as independent contractors to avoid paying the high cost of employee benefits, employment taxes and potential workers compensation claims. It is important to keep in mind that just because an employer treats someone as an independent contractor doesn't mean the IRS will agree.

The general rule is that a worker is an independent contractor if the employer has the right to control or direct only the result of the work and not the means and methods of accomplishing the result. This means that an employer is simply to assign the worker a task and pay the worker when it is accomplished. Typically, however, the work arrangement is not that black and white. If the employer incorrectly characterizes a worker as an independent contractor, the employer can be liable to the IRS for penalties, past employee benefits, employment withholdings, and legal fees to litigate the issue.

When determining a work status, the Courts and the IRS look to the number of factors that are present, as follows:

- employer's level of control over the worker, including hours, place and sequence of work performed
- whether the employer provides training and equipment
- how payment is made to the worker, and whether the worker's business and/or travel expenses are paid
- whether the employer requires full-time services of the worker (this does not exempt part-time workers)
- whether the worker is employed by anyone else
- whether the employer hires, supervises and pays the worker's assistants
- whether the worker is required to submit written or regular reports
- whether the worker has invested in workplace facilities where work is performed
- whether the worker can suffer a loss or realize a profit as a result of work performed on employer's behalf
- whether a continuing relationship with the worker exists
- whether the worker can sever the relationship with the employer without incurring liability
- whether the worker can be fired for reasons other than failing to meet contract specifications
- whether or not there is a written agreement in place between employer and worker classifying the worker as either employee or independent contractor

The overriding determinative factor is degree of employer control over the worker - the greater the control, the more likely the relationship will be deemed one of employer/employee. It is critical for employers to carefully scrutinize factors surrounding a worker's employment before making a decisionto treat a worker as an independent contractor. Mistakes can be very expensive.

In accordance with IRS Circular 230, this newsletter is not to be considered a "covered opinion" or other written tax advice and should not be relied upon for IRS audit, tax dispute, or any other purpose.

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