

Advanced Planning Insights

CLARIFYING THE COMPLEX

Medicaid and annuities

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DID YOU KNOW? The national average monthly cost of a semiprivate nursing-home room was \$8,669 in 2023.¹ Married couples who don't have sufficient long-term care insurance may be the most at risk, as this oversight could quickly deplete investment and retirement assets that took a lifetime to accumulate.

Fortunately, annuities provide opportunities for retirement income if something happens to one of the spouses.

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- Basic Medicaid rules
- Conforming annuities
- Medicaid trusts

No one likes to talk about Medicaid planning—not your client, not you, not even Jackson[®]. It can be a very uncomfortable conversation where clients procrastinate on important decisions and few options remain. Medicaid is also quite complex. It's a federal and state partnership where the rules can vary greatly, sometimes at the county level.

Let's be clear for a minute. Medicaid planning is highly specialized and requires qualified counsel. I know you see that a lot from home offices, but this is serious business. Before proceeding with any planning strategy described below, an elder-law attorney should be consulted. You may know and work with a few. If not, check out the National Academy of Elder Law Attorneys by visiting naela.org.

What is an annuity?

Annuities are long-term, tax-deferred vehicles designed for retirement. Variable annuities involve investment risks and may lose value. Earnings are taxable as ordinary income when distributed. Individuals may be subject to a 10% additional tax for withdrawals before age 59½ unless an exception to the tax is met. Optional living and death benefits, if available, involve additional cost and may be subject to limitations and conditions.

¹ Genworth, Cost of Care Survey, "Monthly Median Cost: National: (2023)," February 22, 2024.

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Basic Medicaid rules²

When a couple applies for Medicaid assistance, they must list all sources of income and all nonexempt assets—investment and savings accounts, IRAs, and even qualified plan balances unless otherwise protected by their state of residence.

Exempt assets generally include the home, car, and some burial insurance contracts. If the couple has more assets than allowed, they're required to "spend down" excess assets before becoming eligible for Medicaid. But the income side of the ledger is treated differently. If something happens to one of the spouses, half of their income can be used by the other spouse—within limits. The "healthy" spouse's income is often not limited.

If only there were a product that could convert an asset into income.

PLANNING POINT. It may be tempting to gift or transfer nonexempt assets to family members or other entities. But most gifted or transferred assets made within the past five years are still considered to be owned by your client.

| ASSETS AND INCOME | |
|-------------------|------------------------|
| Assets | Income |
| Savings | Jim's pension |
| Investments | Jim's Social Security |
| Mary's IRA | Mary's Social Security |
| Cash | Mary's SPIA |

Annuities can conform to Medicaid

Although a single person may purchase an annuity, most of this income would need to be used to support his or her care beyond extremely low thresholds set by each state. However, married couples may greatly benefit from an annuity, as the healthy spouse may be able to enjoy all the income if they are the annuity owner. For this strategy to work, certain rules must be followed to make the annuity contract conform with Medicaid (where allowable).

Current minimum requirements:³

1. The annuity must only provide fixed income and have no cash value. Specifically, it must be a single premium immediate annuity (SPIA) or a deferred annuity that is transferred to a SPIA.
2. The annuity must be unassignable and unable to be commuted back to cash. Purchasing a SPIA is a one-way street. Owners can't simply liquidate or cash out because they need the funds. Nor can they sell it to anyone else.
3. The annuity must be "actuarially sound." For example, a \$100,000 annuity for a spouse with a life expectancy of 10 years can't provide less than \$10,000 a year.
4. Any guaranteed element must not exceed Social Security life expectancy. For example, if Mary is 80 years old, she has 10.2 years of remaining life expectancy.⁴ She can purchase a SPIA for "life with 10-year certain," not "life with 20-year certain."
5. The state or county Medicaid department must be the primary beneficiary and will receive any remaining guaranteed payments until reimbursed for what it spent. Family members may be listed as the contingent beneficiaries should Medicaid disclaim any portion that exceeds reimbursement.

² U.S. Code Section 1382-b, "Resources"; and Section 1396r-5, "Treatment of income and resources for certain institutionalized spouses."

³ Public Law 109-171, Summary of "Chapter 2-long-term Care Under Medicaid" within the Deficit Reduction Act, February 8, 2006.

⁴ Social Security, "Retirement & Survivors Benefits: Life Expectancy Calculator," estimate as of Friday, February 23, 2024.

Let's take a closer look into putting this planning into practice

Most insurance companies issue immediate annuities. Some will offer an ownership restriction endorsement that conforms with Medicaid. But, when interest rates are low and your client is quite advanced in age, meeting the actuarially sound requirements can be tricky. Researching the correct departmental name and address of the primary beneficiary may be as simple as a web search or may be provided by the elder law attorney. You can also research whether Medicaid-compliant annuities may be allowed in your client's state of residence by visiting the state-specific summary data at elderlawanswers.com.

Does Jackson offer a Medicaid annuity?

Due to the nuanced and varying regulations across jurisdictions, Jackson does not market or certify its immediate annuities as Medicaid compliant. However, Jackson does issue immediate annuities but may not have a selling agreement with all broker/dealers. Guaranteed elements can be designed to be within allowable life expectancy and to accept Medicaid as a listed beneficiary. Jackson also offers an ownership restriction endorsement in most states outside of New York.

However, as Jackson does not guarantee the effectiveness of this strategy, we do not call our endorsement a "Medicaid rider." Nor do we certify that our annuity conforms with all state and local requirements. This is where a qualified legal advisor should be consulted, and a financial professional needs to be careful. Many jurisdictions do not look favorably on using immediate annuities solely for the purpose of qualifying for Medicaid. Some jurisdictions also have communicated to insurance carriers that those carriers may not issue an immediate annuity if the purchaser represents that the sole purpose of the annuity is to qualify for Medicaid.

PLANNING POINT. Deferred annuities—even those with lifetime withdrawal benefits—do not appear to meet the Medicaid-conforming requirements. Annuitization of a deferred annuity may likewise be nonconforming.

So, how do you protect a deferred annuity's income designed to help provide financial freedom for life?

Medicaid trusts

With proper planning, substantial wealth—including annuities—may be moved into an irrevocable trust fund that may remove them from Medicaid consideration. These trust funds generally come in two flavors: nongrantor and grantor trusts.

Nongrantor trusts

With this type of trust, the client irrevocably gives up all rights of ownership of the trust assets, including income. They also give up rights of substitution—what goes into the trust stays in the trust until the trust dissolves. Essentially, the grantor is treated like they are deceased or never owned the assets.

Although a highly effective strategy for removing assets from your Medicaid and gross taxable estate, nongrantor trusts are not common in the Medicaid arena, as few seniors can sever connection to their investments and associated income. Trust tax rates would apply to all income and dividends retained by the trust and not paid out to trust beneficiaries.

A nongrantor trust is typically used for estate tax planning when the goal is to leave assets to children, grandchildren, and future descendants. Nongrantor trusts are often used to control assets left to trust beneficiaries. This trust type can potentially benefit from deferred annuities as described in other Jackson sales literature. Deferred annuities in trusts may help trustees to more effectively manage the timing and recognition of trust income.⁵

⁵ IRC 72(u)(1).

Grantor trusts

Of the two, grantor trusts are far more common in Medicaid planning. Clients retain rights that may not be otherwise allowed in a nongrantor trust such as:

1. The right for a “healthy” spouse to receive income.
2. The grantor retains tax ownership of the underlying assets, so the trust and estate tax rates do not apply.
3. If the grantor has a retained-income right, an annuity may help guarantee it. Amounts not withdrawn from a tax-deferred* annuity are not currently taxable to either the trust or grantor.

A peek at these charts clearly shows the income tax advantage of a grantor trust.

| 2024 ESTATE AND TRUST TAX RATES | |
|---------------------------------|-----------------------|
| \$0 - \$3,100 | 10% of taxable income |
| \$3,101 - \$11,150 | \$310 + 24% |
| \$11,151 - \$15,200 | \$2,242 + 35% |
| \$15,201+ | \$3,659.50 + 37% |

Source: IRS, Revenue Procedure 2023-34.

| 2024 TAX RATES (MARRIED FILING JOINTLY) | |
|--|-----------------------|
| \$0 - \$23,200 | 10% of taxable income |
| \$23,201 - \$94,300 | \$2,320 + 12% |
| \$94,301 - \$201,050 | \$10,852 + 22% |
| \$201,051 - \$383,900 | \$34,337 + 24% |
| \$383,901 - \$487,450 | \$78,221 + 32% |
| \$487,451 - \$731,200 | \$111,357 + 35% |
| \$731,201+ | \$196,669 + 37% |

Source: IRS, Revenue Procedure 2023-34.

PLANNING POINT. If the client retains tax ownership of the trust assets, and the measuring life of the annuity does not change, Jackson will generally allow a transfer of ownership of an existing Jackson annuity from an individual to that individual’s grantor trust without interrupting tax deferral,* while preserving optional living and death benefits. This is a complex strategy, and individuals should consult with an estate planning attorney before attempting to change ownership of any asset—including an annuity—to a trust.

Check with the issuer, including the Jackson Service Center, before attempting to transfer ownership of an annuity.

How Jackson® Can Help

Medicaid and annuities are complex topics. An elder law attorney should drive this planning with you taking a role to fulfill funding when an annuity may be appropriate. Nobody at Jackson can offer you specific legal or tax advice, and we cannot comment on suitability. But our Advanced Strategies team will review the rules of conforming annuities to Medicaid with you. We can also show you how annuities and trusts may help your clients reach their unique goals.

* Tax deferral offers no additional value if an IRA or a qualified plan, such as a 401(k), is used to fund an annuity and may be found at a lower cost in other investment products. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

To learn more about Medicaid and annuities, please call:

Bank and Financial Institution Representatives: 800/777-7900; in New York: 888/464-777

Independent and Non-Bank Broker/Dealer Representatives: 800/711-JNLD (5653)

Wirehouse/Regional Representatives: 800/340-JNLD (5653)

RIA and Wealth Managers: 800/711-7397

Insurance Platforms: 800/711-7305

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