

Medicaid Asset Protection: Lady Bird Deeds in Texas



THE HALE LAW FIRM
A PROFESSIONAL CORPORATION

Last Updated
August 2013

John D. Hale
Attorney

Contact:

(214) 446-5080
johale@thehalelawfirm.com

417 W. MAIN STREET
WAXAHACHIE, TEXAS 75165

ARLINGTON · DALLAS · FT. WORTH · PLANO · WAXAHACHIE

Medicaid Asset Protection: Lady Bird Deeds in Texas

Every state is required to maintain a Medicaid estate recovery program as a condition to continued receipt of federal Medicaid funds. This federal requirement, passed down to the states for implementation, has resulted in the widespread use of various Medicaid asset protection planning strategies. In Texas, perhaps no single strategy is more important than the Lady Bird Deed.

A Lady Bird Deed, also known as an Enhanced Life Estate Deed, a Deed with a Power of Appointment, and a Transfer-On-Death Deed, is a legal document in which the grantor transfers property to his or her heirs while at the same time retaining a life estate with powers including the right to sell the property.

Texas is one of just a few states which permit the use of Lady Bird Deeds and only nine states (Arizona, Arkansas, Colorado, Kansas, Missouri, Nevada, New Mexico, Ohio and Wisconsin) have actually adopted the planning technique by statute.¹

Fundamentally, the Lady Bird Deed is what elder law attorneys use to protect a Medicaid recipient's home and other real property from the Medicaid Estate Recovery Program (MERP). Other devices such as the revocable living trust have been used in the past, but as established in this white paper, planning tools often fall out of favor as Medicaid eligibility rules are modified.

This paper begins by examining the Medicaid eligibility rules concerning home ownership and other commonly held interests in real property. The paper continues by discussing the Texas Medicaid Estate Recovery Program to lay the foundation for determining whether or not a Lady Bird Deed is necessary to protect the home or other real property from estate recovery. Finally, this white paper pulls together the Texas Medicaid long-term care eligibility and estate recovery rules to discuss how the Lady Bird Deed provides asset protection and its drawbacks.

Medicaid Long-Term Care Eligibility and Real Estate

In order to qualify and maintain eligibility for Medicaid long-term care services, the applicant/recipient must satisfy a number of criteria. Oftentimes the most difficult criterion to meet is the countable resource limit. If a Medicaid applicant's "countable resources" exceeds the applicable Medicaid eligibility resource limit as of 12:01 a.m. on the first day of the month, the applicant is ineligible for services for the entire month.²

¹ Comparing Key Strategies in Owning the Home: Estate Planning, Tax and Medicaid Considerations – Part One, 219 Elder L. Advisory 1 (May 2009).

² 1 Texas Administrative Code §358.321(c).

Excluded Resource -- The Home

Medicaid does not count the equity value of a home that is the principal place of residence of a person or spouse provided the home is in Texas and the person or spouse lives in the home or intends to return to the home.³ However, if the person's home equity interest exceeds \$536,000 (2013 figure based on CPI-adjusted inflation) the excessive home equity counts against the resource limit unless either of the following is lawfully residing in the person's home:

- the person's spouse; or
- the person's child if the child is under age 21, or is blind or permanently and totally disabled.⁴

If the person transfers ownership of the home for less than fair market value while the home is excluded, the transfer nullifies the exclusion effective 12:01 a.m. of the first day of the following month,⁵ and a transfer penalty will be imposed unless the title is transferred to the person's:

- spouse who lives in the home (the transfer penalty applies when the community-based spouse transfers the home without full compensation);
- minor child under age 21 or child who is disabled. Disability must meet Social Security Administration (SSA) disability criteria. Additionally, there is no age limit for the person's child who is determined disabled under the SSA criteria;
- sibling who has equity interest in the home and has lived there for at least one year before the person's institutionalization;
- son or daughter (other than a disabled or minor child) who lived in the home for at least two years before the person's institutionalization and provided care that prevented institutionalization. To substantiate this claim, there must be a written statement from the person's attending physician or a professional social worker familiar with the case documenting the care provided by the son or daughter. If the person is or has been receiving services through a home and community-based waiver program, a statement from the DADS case manager or a professional social worker familiar with the case is required if the person transfers the home to a son or daughter who lives in the home, thereby preventing institutionalization. Since the services of the waiver are to prevent institutionalization, justification is required to show that additional care provided by the son or daughter is necessary to prevent institutionalization; or

³ 1 Texas Administrative Code §358.348.

⁴ §F-3600 of Texas MEPD Handbook.

⁵ 1 Texas Administrative Code §358.348(b).

- children, siblings, etc., if the deed is an enhanced life estate and has been approved by the regional attorney. The person must sign a statement that he intends to return to the home.⁶

If the home is placed in a revocable living trust, the home will lose its exclusion as a homestead and become a countable resource. The person may be able to reestablish the property as a homestead by removing it from the revocable trust;⁷ however, the medical effective date for Medicaid services cannot precede the first of the month after the date the home was removed from the trust.⁸

If a person is purchasing a replacement home, the proceeds of the sale of the original home are not countable resources for three full months following the month of receipt. Any proceeds in excess of the cost of replacing and occupying the home are countable resources.⁹

Excluded Resource – Real Estate Placed For Sale

Often the Medicaid applicant or recipient owns real property that cannot be properly designated as a homestead. In such cases, the property can be excluded as a countable resource by making a reasonable effort to sell it. Once the property is sold, the equity value received is a countable resource in the month following the month of sale. If the sale was for less than fair market value or current market value, the sale of the property may result in the imposition of a transfer penalty.¹⁰

Texas Medicaid Estate Recovery Program (MERP)

In the Federal Omnibus Budget Reconciliation Act of 1993, as a condition to receiving federal funding for Medicaid services, each state is required to implement an estate recovery program.

For years the Texas Legislature delayed implementation of an estate recovery program because of its immense unpopularity among Texans. Finally, in 2003, as one of the last three states to pass an estate recovery program, Texas passed a law to comply with the 1993 federal mandate.

⁶ §I-3100 of Texas MEPD Handbook.

⁷ §F-3210 of Texas MEPD Handbook.

⁸ §F-3211 of Texas MEPD Handbook.

⁹ §F-3400 of Texas MEPD Handbook.

¹⁰ 1 Texas Administrative Code §358.349.

The Medicaid Estate Recovery Program, also known as MERP, went into effect in Texas on March 1, 2005. The purpose of MERP is to comply with applicable federal law at 42 U.S.C. §1396p(b)(1), which requires the State Medicaid Agency to implement a program to recover the costs of certain Medicaid benefits received by certain Medicaid recipients.¹¹

MERP Applicability

Under 42 U.S.C. §1396p(b)(1), the state is required to recover expenditures from the estate of a deceased Medicaid recipient, age 55 or older, who received Medicaid for certain long-term services and supports on or after March 1, 2005. The following long-term services and supports are subject to MERP:

- Nursing facility services;
- Intermediate care facility for persons with mental retardation (ICF/MR) services, which include state supported living centers;
- Medicaid waiver programs, such as:
 - Community Living Assistance and Support Services (CLASS);
 - Deaf Blind with Multiple Disabilities (DBMD);
 - Home and Community-based Services (HCS);
 - Texas Home Living Program (TxHmL);
 - Consolidated Waiver Program (CWP); and
 - Community Based Alternatives (CBA), which includes Star Plus services; and
- Community Attendant Services (CAS); and
- Hospital and prescription drug services received while on the above programs.¹²

MERP Limited to the Probate Estate

The federal statute does not set forth rules for estate recovery; however, it authorizes the State Medicaid Agency – in Texas, the Health and Human Services Commission (HHSC) – to fashion rules in compliance with federal Medicaid law. Following passage of the 2003 MERP statute, the Texas Legislature encouraged HHSC to implement a lenient estate recovery program within federal parameters.¹³ The result was a MERP program limiting estate recovery to the “probate estate” of the deceased Medicaid recipient.¹⁴

¹¹ 1 Texas Administrative Code §373.101.

¹² 1 Texas Administrative Code §373.103.

¹³ The Texas Department of Aging and Disability Services Reference Guide (2006) states: “MERP was written into Texas law as part of House Bill 2292, passed in 2003 by the 78th Regular Session of the Texas Legislature. As the state’s Medicaid agency, the Health and Human Services Commission was responsible for developing the program

The probate estate does not include property disposed of by the decedent during his or her lifetime.¹⁵ In addition, §450(a) of the Texas Probate Code provides that transfer on death provisions in a written instrument effective as a contract, gift, conveyance or trust is nontestamentary, or in other words not part of the probate estate. Examples of such written instruments include: life insurance policies, deposit agreements, retirement accounts, trust agreements and *conveyances of real property*, among others. MERP recognizes the distinction between the probate estate and the nonprobate estate in its estate recovery efforts.¹⁶

Exemptions, Waivers and Allowable Deductions to MERP Probate Claims

The acceptance of Medicaid assistance provides a basis for a Class 7 probate claim, as defined in § 322 of the Texas Probate Code, against the deceased Medicaid recipient's probate estate.¹⁷ As an unsecured creditor, Texas has a right to recover from the decedent's probate estate subject to certain exemptions,¹⁸ waivers¹⁹ and allowable deductions for certain expenses paid on behalf of the estate.²⁰

TAC §373.201(a) Exemptions

(a) Medicaid Estate Recovery claims will be sought only after the death of the Medicaid recipient, and if there is no:

(1) Surviving spouse;

requirements. The MERP rule finalized in the Texas Administrative Code in December 2004, was fashioned as a very lenient program within the federal parameters." p.19.

¹⁴ For purposes of MERP, "Estate" is defined as "[t]he real and personal property of a decedent, both as such property originally existed and as from time to time changed in form by sale, reinvestment, or otherwise, and as augmented by any accretions and additions and substitutions that are included in the definition of the probate estate found in §3(1), Definitions and Use of Terms, Texas Probate Code." 1 Texas Administrative Code §373.105(6).

¹⁵ *Markward v. Murrah*, 138 Tex. 34, 156 S.W.2d 971, 138 A.L.R 242 (1941). See also, Tex. Jur. 3d Decedents' Estates §70.

¹⁶ Form 8001 Medicaid Estate Recovery Form Receipt Acknowledgement Form (September 2012), Texas Department of Aging and Disability Services.

¹⁷ 1 Texas Administrative Code §373.201.

¹⁸ 1 Texas Administrative Code §373.207.

¹⁹ 1 Texas Administrative Code §373.209.

²⁰ 1 Texas Administrative Code §373.213.

- (2) Surviving child or children under 21 years of age;
- (3) Surviving child of any age who is blind or disabled as defined by 42 U.S.C. §1382c;
or
- (4) Unmarried child residing continuously in the decedent's homestead for at least one year prior to the time of the Medicaid recipient's death.

TAC §373.209 Waivers

- (a) The Medicaid Estate Recovery Program (MERP) will not recover from estates if recovery would cause undue hardship. An undue hardship waiver request form will be provided with the MERP Notice of Intent to File a Claim, and undue hardship waiver requests must be made within 60 days of the date of the MERP Notice of Intent to File a Claim.
- (b) An undue hardship does not exist solely because:
 - (1) Recovery would prevent heirs or legatees from receiving an anticipated inheritance;
or
 - (2) The circumstances giving rise to the hardship were created by, or are the result of, estate planning methods under which assets were sheltered or divested contrary to the requirements of Medicaid law in order to avoid estate recovery.
- (c) Undue hardship waivers include:
 - (1) The estate property subject to recovery has been the site of the operation of a family business, farm or ranch at that location for at least 12 months prior to the death of the decedent; is the primary income producing asset of heirs and legatees; and produces 50 percent or more of their livelihood; and recovery by the State would affect the property and result in the heirs or legatees losing their primary source of income;
 - (2) Heirs and legatees would become eligible for public and/or medical assistance if a recovery claim were made;
 - (3) Allowing one or more survivors to receive the estate will enable him or her or them to discontinue eligibility for public and/or medical assistance;
 - (4) The Medicaid recipient received medical assistance as the result of a crime, as defined by Texas law, committed against the recipient; or

(5) Other compelling reasons.

(d) Undue Hardship Waivers Applicable to Homesteads. After receiving a Medicaid estate recovery claim, an heir may assert that recovery against a deceased Medicaid recipient's homestead would be an undue hardship and that the homestead should therefore be exempt from recovery for the cost of Medicaid long-term care services. The Health and Human Services Commission will exempt a decedent's home from estate recovery based on undue hardship when the following conditions have been established to the Commission's satisfaction:

- (1) The tax appraisal district value of the homestead is less than \$100,000. If the tax appraisal value of the homestead exceeds this amount, the first \$100,000 of the tax appraisal district value for the most recent tax year at the time of the recipient's death shall be exempt from estate recovery. Any equity value of the tax appraisal district value for the most recent tax year at the time of the recipients' death in excess of \$100,000 is subject to estate recovery.
- (2) One or more siblings or direct descendants of the deceased person (lineal heir(s), such as children and grandchildren) will inherit the homestead of the deceased Medicaid recipient, provided each sibling or lineal heir inheriting the homestead has gross family income below 300 percent of the Federal Poverty Level.
- (3) When there are multiple heirs and not all heirs qualify the hardship waiver, only that percentage of the homestead that corresponds to the qualifying heir or heirs' share of the homestead will be exempt from Medicaid estate recovery.
- (4) "300 percent of the federal poverty limit" is a gross income test; no exclusion or deductions are allowed.
- (5) "Family" means that the Health and Human Services Commission will consider each heir separately. Heirs will not be aggregated into one family unless the heirs are minor children who are siblings. In the case of the adult heir, his or her family will be limited to the heir, the heir's spouse, and the heir's biological or legally adopted minor children and stepchildren residing in the household. In the case of the heir who is a minor, the heir's family will be the heir, his or her parent(s) or stepparent residing in the household, and the heir's minor siblings residing in the household, including half-, step-, and legally adopted siblings.

(e) HHSC has exclusive authority to waive its Medicaid estate recovery claim and grant undue hardship waivers as determined by the Medicaid Estate Recovery Program (MERP) program

on an individual case-by-case basis. An undue hardship waiver determination will be made by MERP within 40 days of the receipt of an undue hardship waiver request form and all required necessary supporting documents by MERP.

- (f) Undue hardship waiver request forms must be submitted to the following address: MERP, Hardship Waiver Request, P.O. Box 13247, Austin, Texas 78711.

TAC §373.213 Deductions

- (a) An amount equal to necessary and reasonable maintenance expenses and taxes may be deducted from the Medicaid Estate Recovery Program (MERP) claim for maintaining the home of the deceased Medicaid recipient, provided that sufficient supporting documentation of these expenditures, such as receipts, is provided to MERP by estate personal representatives, heirs, or legatees. Necessary and reasonable expenses for maintaining the home include real estate taxes, utility bills, insurance, home repairs, and home maintenance expenses such as lawn care.
- (b) An amount equal to the necessary and reasonable expenses for the direct payment of the costs of care (including payment of personal attendant care) provided for a deceased Medicaid recipient that enabled the recipient to remain in his or her home and thereby delayed the institutionalization of the Medicaid recipient may be deducted from the MERP claim, provided that sufficient supporting documentation of these expenditures, such as receipts, is provided to MERP by estate personal representatives, heirs, or legatees.
- (c) Requests for obtaining allowable deductions from MERP claims for expenses under subsections (a) or (b) of this section must be made in writing within 60 days after receipt of the Notice of Intent to File a Claim by MERP. All supporting documentation must be attached to the request and sent to MERP, Home Maintenance/Costs of Care Request, P.O. Box 13247, Austin, Texas 78711.

Lady Bird Deed as Instrument for Medicaid Asset Protection

Lady Bird Deeds work in Texas because they operate within the Medicaid eligibility rules while simultaneously removing real property from the probate estate of the Medicaid recipient to shelter the property against MERP. How is this possible?

Not a Transfer of Assets

HHSC will impose a transfer penalty against a Medicaid applicant if he or she transfers property to another for less than fair market value within five years (or sixty months) of applying for

Medicaid unless an exception applies. The transfer penalty is calculated in days and represents the number of days an individual will be denied Medicaid services even though he or she otherwise meets the Medicaid eligibility rules. This transfer penalty period begins upon being approved for Medicaid services – not when the gift was actually made.²¹

As previously addressed in this white paper, an exception to the imposition of a transfer penalty applies in the case of a Lady Bird Deed.²² A transfer penalty is avoided because the grantor of a Lady Bird Deed retains a life estate and the right to sell the property and keep the proceeds of sale. The deed is merely a transfer-on-death designation that may or may not result, similar to a beneficiary designation in a bank deposit agreement.

Importantly, HHSC requires “enhanced life estate” deeds, i.e. Lady Bird Deeds, to be submitted for review by a HHSC regional attorney.²³ To reduce the chance of an adverse legal review and to protect the grantor’s rights in the property, elder law attorneys typically reserve the following rights or interests in the Lady Bird Deed:

- A life estate – the right to use, possess, and collect income from the property for life;
- The right to sell the property and keep the proceeds of sale;
- The right to mortgage the property and consume the equity; and
- The right to revoke or amend the deed.

Not Part of the Probate Estate

While the Lady Bird Deed does not convey an equitable interest in the property during the grantor’s lifetime, it conveys legal title subject to the grantor’s retained rights in the property. Once the grantor dies, these retained rights terminate vesting title in fee simple to the grantee. Inasmuch as the grantee now holds both legal and equitable title to the property, no interest in the property is part of the grantor’s probate estate.

Tax Implications of the Lady Bird Deed

No Federal Gift Taxes

Unlike other deeds, a Lady Bird Deed does not transfer any incidents of ownership in the property. Because the grantor does not actually transfer ownership of the property by executing a Lady Bird Deed, no federal gift tax issues arise.

²¹ 1 Texas Administrative Code §358.401.

²² §I-3100 of Texas MEPD Handbook.

²³ Id.

No Lost Step-Up in Basis for Capital Gain Taxes

When the grantee of a Lady Bird Deed receives the property at the grantor's death, it is included in the grantor's gross estate and thus receives a step-up in basis.²⁴ The property is included in the grantor's gross estate because "the decedent had an interest" in the property.²⁵ When property is included in the grantor's gross estate for tax purposes and the property is acquired from the deceased grantor by reason of death, the property receives a stepped-up basis.²⁶ Therefore, the basis in the property steps-up to the fair market value of the property upon the grantor's death, reducing (or perhaps even eliminating) any capital gain taxes upon the sale of the property by the grantee.

No Lost Texas Property Tax Exemptions

Lady Bird Deeds do not prevent the grantor from occupying the real property. Therefore, provided the property is the grantor's homestead, he or she can continue to claim the homestead exemption, and over 65 or disabled homeowner exemptions permitted under Texas Tax Code §11.13.

Potential Drawbacks of the Lady Bird Deed

Law Could Change

Lady Bird Deeds are not without potential shortcomings. The law is subject to change. There is no guarantee that federal or state law will always permit the use of Lady Bird Deeds or that actions taken prior to such a change in law will be grandfathered. A recent example on point is HHSC's December 2009 revised MEPD policy §F-3210 which states: "A home placed in a revocable or living trust (or similar type trust) loses the exclusion as a homestead and becomes a countable resource"

Title Insurability

In the vast majority of cases, when real property is purchased, sold or mortgaged title insurance is purchased to provide protection against defects in title. While there are approximately eighteen title companies authorized to sell title insurance in Texas, they each take a different approach to the risks they are willing to insure against. Because there is no uniformity in title coverage between insurers, holders of Lady Bird Deeds may run into obstacles when trying to obtain title insurance for the purpose of selling or mortgaging the property.

Underwriters are aware of MERP, but generally do not understand the importance of MERP's claims being limited to the probate estate of the deceased Medicaid recipient. As a result, some

²⁴ IRC §2036.

²⁵ IRC §2033.

²⁶ IRC §1014(b)(9).

title companies require HMS (the Medicaid estate recovery contractor for Texas) to provide a release of claim before they will insure title. This requirement by some underwriters either reflects a misinterpretation of MERP as a lien statute (as opposed to a claim statute) or unwillingness to assume the risk of paying legal expenses defending against a frivolous MERP claim even if remote.²⁷

The National Academy of Elder Law Attorneys (NAELA) and in particular, Patricia F. Sitchler, Esq., has done much to inform Texas title underwriters about elder care issues and the use of Lady Bird Deeds. Increasingly, title companies appear to be willing to “strike a balance between the real needs of Elders and their families and the need of the title company to protect it against fraudulent transactions and the resulting losses and expenses.”²⁸

**FOR MORE INFORMATION OR TO PREPARE A LADY BIRD DEED
CALL 1-888-425-3911**

NOTICE: Legal issues are complex and highly fact specific and require legal expertise that cannot be provided by any single article. In addition, laws change over time and vary by jurisdiction. The information in this article does not constitute legal advice and should not be used as a substitute for obtaining personal legal advice and consultation prior to making decisions regarding individual circumstances.

IRS CIRCULAR 230 DISCLOSURE: To insure compliance with requirements by the IRS, we inform you that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under federal, state or local law or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

²⁷ Kristen Quinney Porter and Patricia F. Sitchler, *Where Real Estate and Estate Planning Collide*, UTCLE, Aug. 2012.

²⁸ Stewart Title Guaranty Company, *Stewart Bulletin*, Feb. 11, 2013.