KRAUSE FINANCIAL

MEDICAID COMPLIANT ANNUITIES VS. PROMISSORY NOTES

Which tool is best suited for your client's Medicaid spend-down plan?

Spending Down Assets for Medicaid

When seeking Medicaid benefits for long-term care, most people have too many assets to qualify. Fortunately, the Deficit Reduction Act of 2005 (DRA) identifies and provides the framework and requirements for certain tools applicants can use to spend down their assets and qualify for benefits. Two of these tools include Medicaid Compliant Annuities (MCAs) and promissory notes.

Medicaid Compliant Annuities and promissory notes are two options crisis planning clients can use to spend down their excess countable assets.

In order to provide the best spend-down guidance to your clients, it's vital you understand MCAs and promissory notes and how each instrument can be used to preserve assets and accelerate Medicaid eligibility. Let's explore these tools in more detail, compare the two products, and determine which option is more practical for your client's situation.

- Define the Medicaid Compliant Annuity and its use in Medicaid planning.
- Explore promissory notes and how they're used in crisis planning.
- Compare the pros and cons of MCAs and promissory notes.
- Determine which tool is best suited for your client.

Understanding the key similarities and differences between MCAs and promissory notes allows you to guide your client toward the spend-down product that is best for them.

What Is a Medicaid Compliant Annuity?

A Medicaid Compliant Annuity (MCA) is a single premium immediate annuity with additional provisions to comply with the DRA. It consists of a contract with an insurance company that provides monthly payments in exchange for a lump-sum premium.

MEDICAID PLANNING WITH MCAS

Medicaid Compliant Annuities are used to convert excess countable resources into a monthly income stream. An MCA is controlled by an insurance company. The owner, annuitant, and payee are typically the same person—either the Medicaid applicant or the community spouse. When properly structured, an MCA immediately eliminates countable assets and accelerates Medicaid eligibility.

MCAs are available in 49 states and the District of Columbia. Plus, when you work with Krause Financial, we ensure the annuity meets the specific requirements of your state's Medicaid program.

An MCA provides a strong, secure contract with a guaranteed payout.

REQUIREMENTS OF AN MCA

IRREVOCABLE
The payment amount, term, and parties of the annuity cannot be altered.

NON-ASSIGNABLE
The contract cannot be assigned to another party or sold on the secondary market.

ACTUARIALLY SOUND
The term of the annuity must be fixed and equal to or shorter than the owner's Medicaid life expectancy.

EQUAL PAYMENTS
The annuity must provide equal monthly payments with no deferral or balloon payments.

STATE AS BENEFICIARY
In most cases, the state Medicaid agency must be named primary death beneficiary to the extent of benefits paid on behalf of the institutionalized individual.

RATE OF RETURN

The rate of return on an immediate annuity is low and determined by the insurance company. For interest earned in a calendar year exceeding $10, the insurance company issues a 1099 to the contract owner.

What is a Promissory Note?

A promissory note is a written instrument in which one party, known as the maker or borrower, promises to pay a specific sum of money to another party, known as the payee or lender. The promise is typically made between family members or other loved ones.

MEDICAID PLANNING WITH PROMISSORY NOTES

Promissory notes are typically used in crisis planning to convert excess countable resources into a monthly income stream. The lender provides a sum of money or assets to the maker, who then returns the funds to the lender with interest over the term of the note. In crisis planning, the lender is the Medicaid applicant or community spouse, and the maker is typically an adult child or other loved one. When properly structured, a promissory note immediately eliminates countable assets and accelerates Medicaid eligibility.

However, it's important to note the treatment of promissory notes varies by state. In many states, this tool cannot be used in Medicaid planning. In states where promissory notes are viable, the note must be drafted very carefully to ensure it meets all requirements. Additionally, since the contract is with an individual, the funds may be at risk of seizure due to a disruptive financial event, such as divorce, bankruptcy, or death.

The funds in a promissory note are at risk if the maker experiences divorce, bankruptcy, death, or some other disruptive financial event.

REQUIREMENTS OF A PROMISSORY NOTE

NON-ASSIGNABLE

The contract cannot be assigned or sold to another party.

ACTUARIALLY SOUND

The repayment term of the note cannot exceed the lender's Medicaid life expectancy.

EQUAL PAYMENTS

The note must provide equal payments with no deferral or balloon payments.

MAY NOT CANCEL UPON LENDER'S DEATH

The note must prohibit the cancellation of the balance upon the death of the lender. The monthly payments continue to the lender's estate (forced probate).

RATE OF RETURN

A promissory note does not require a specific rate of return. As long as the loan amount returns within the lender's Medicaid life expectancy, it is considered actuarially sound. However, if the IRS were to audit the case and find the promissory note did not include a minimum rate of return, it could apply imputed interest to the case, known as the Applicable Federal Rate (AFR). Assuming the maker pays the AFR interest on the promissory note, they must complete a Form 1099-INT and submit one copy to the lender and one to the IRS.

Comparing MCAs and Promissory Notes

With a stronger understanding of both MCAs and promissory notes, which one is ideal for your client's situation?

WHEN TO USE A PROMISSORY NOTE:

- Your client needs to spend down non-cash assets, such as land or other property besides the primary home.
- Promissory notes are a viable spend-down tool in your client's state of residence.

WHEN TO USE A MEDICAID COMPLIANT ANNUITY

- Your client needs to spend down liquid assets, whether qualified or non-qualified.
- Your client desires a secure contract with a guaranteed payout.
- You want a reliable product with no longterm management for the attorney.

PROMISSORY NOTES

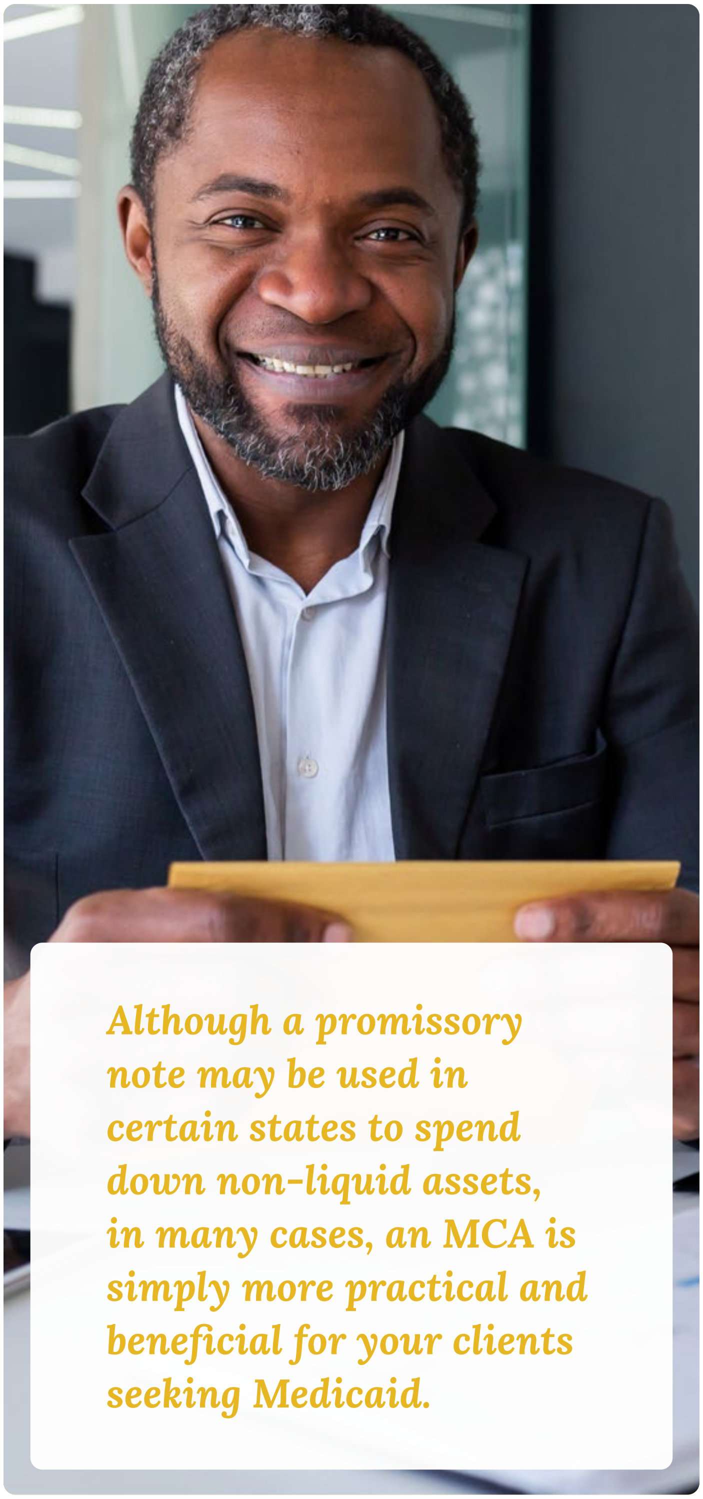
Pros	Cons
Can be used to transfer non-cash assets, such as real estate	Funds subject to disruptive financial events
Typically established with a loved one	May require long-term maintenance by the attorney
May have a smaller cost than a short-term annuity	Not permitted to hold tax-qualified funds
	Interest must be paid out of pocket
	May undergo more scrutiny by the state

MEDICAID COMPLIANT ANNUITIES

Pros	Cons
Securely established with an insurance company	Small processing fee for short-term MCAs
Guaranteed payout	Subject to estate recovery if the owner predeceases the term
No long-term management for the attorney	
Little scrutiny by the state	
May be funded with either qualified or non-qualified funds	

Discuss Your Case With Us

If you’re not sure whether an MCA or a promissory note is better suited for a specific case, simply contact our office! We can provide a custom analysis for your client’s case, including a product recommendation and the projected economic results.



Although a promissory note may be used in certain states to spend down non-liquid assets, in many cases, an MCA is simply more practical and beneficial for your clients seeking Medicaid.

SCHEUDLE A CALL

Schedule a call with one of our advisors to discuss your case in more detail.

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