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Private Loans and Reverse Mortgages in Medicaid and VA Pension Planning

Often seniors are given informal financial support by their family members. If the senior owns real estate, the better approach for a family member providing financial support would be to loan the senior money. Collateral for the loan would be in the form of a private reverse mortgage. This allows the family member to be reimbursed for the expenses without having the money be penalizable gifts from Medicaid's point of view.

Often new clients come to an elder law attorney in a crisis situation in which the attorney finds that family members have provided informal financial support to the seniors, and now that the seniors need to apply for Medicaid, the family members hope to be reimbursed as part of the seniors spending down to their countable asset limit. Another variation is that the seniors are now selling their home and the family members who provided financial support to enable the parents to remain in their home hope to be reimbursed from the sale proceeds. The elder law attorney learns that there is no prospective documentation that the payments from family members to seniors — usually children to parents — were loans rather than gifts.

Unfortunately, the presumption for Medicaid agencies is that such financial supports are gifts to the seniors, rather than loans. Reimbursement will then be treated as penalizable transfers from the seniors to the family members unless the elder law attorney effectively rebuts the presumption that the original payments to the seniors were gifts, and that the reimbursements were penalizable gifts.

A similar situation arises when a senior who is a wartime veteran or the surviving spouse of a wartime veteran applies for VA pension with aid and attendance to help provide funds to afford home care or assisted living. If a family member pays a portion of the costs of caregivers or facility costs, the portions paid directly by the family

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member do not qualify as "unreimbursed medical expense" (UME) for purposes of calculating the claimant's "income for VA purposes" (IVAP), which is key to the determination of the claimant's cash benefit. The claimant needs to pay the expenses in order for them to qualify as UME.

Additionally, now that the VA has instituted a transfer penalty and lookback period for the pension program, effective on October 18, 2018, when the claimant receives a retroactive lump-sum benefit payment upon finally getting fully approved, and if necessary a VA fiduciary appointed, that lump sum cannot be used to reimburse the family member who made informal payments to caregivers or a facility directly, or even who provided funds to the senior to enable the senior to pay those costs.

A Different Kind of Reverse Mortgage

The solution in all of these situations is for the family member to make a documented loan to the senior, rather than informal, undocumented payments. A loan documented by a promissory note is a debt of the senior to the family member, which when paid back is not a gift. If the senior owns real estate, the better approach would be for the family member, whom I will now call the lender, to have received collateral for the loan in the form of a private reverse mortgage.

Elder law attorneys are probably all aware that the concept of a reverse mortgage is that the homeowner gets a loan from the reverse mortgage lender, and is obligated to maintain the home, pay taxes and insurance to protect the home, but does not have to pay installments to repay the principal and accrued interest of the loan. Some reverse mortgage loans pay the borrower a lump sum, others are set up to pay the borrower monthly installments, and others are merely lines of credit against the homeowner's equity in the home. The borrower's debt merely accumulates, to be paid back when the property is sold or the mortgage is foreclosed, as described in the next paragraph.

A simple "demand promissory note" executed by the borrower (or by his or her agent under power of attorney with appropriate power pursuant to state law) transforms what otherwise would be construed to be a gift from the family member to the senior into a documented loan.

Commercial reverse mortgages are only available for owner-occupied homes in which one of the homeowners — the qualified homeowner — is age 62 or older. Additionally, if the qualified homeowner dies or vacates the home for one year, the reverse mortgage loan becomes due. Banks that make these reverse mortgage loans that have become due are typically very aggressive in pursuing repayment or will foreclose on the reverse mortgage. None of these commercial reverse mortgage restrictions or adverse outcomes are necessary if the lender is a family member whose loan is secured by a private reverse mortgage.

A private reverse mortgage borrower can be of any age, not necessarily age 62 or older. The private reverse mortgage can omit a provision forcing repayment if the owner vacates (such as to move into a nursing home), and a private reverse mortgage can apply to any real estate, not just the borrower's home. Such flexibility can make it possible for a borrower to live anywhere while the lender provides funds to maintain the home, home, former home, investment property, or whatever real estate is involved.

A favorable feature of commercial reverse mortgages is that they are "nonrecourse" loans. This means that when the home is eventually sold if the debt cannot be fully satisfied by the sale, the lender cannot come after the borrower personally to pay any deficiency. Instead, commercial reverse mortgage loans are accompanied by a mortgage insurance policy that pays the lender any deficiency that may exist from the sale of the home. This makes the lender whole, and it avoids the borrower incurring cancelation of debt taxable income; there is no cancelation of debt because the mortgage insurance policy purchased by the borrower pays the debt to the lender.

Private Family Loan

Often in elder law practices, senior clients own a home, but they may also

own a vacation camp, cottage, or income-producing property. Often a goal of planning is not to sell the properties during the seniors' lifetimes and receive sale proceeds that include taxable capital gains and state income, but rather to maintain ownership of the properties until the deaths of the seniors in order for the properties to receive a step-up of cost basis to the date of death value, after which the properties will be distributed to the deceased seniors' estate devisees or trust beneficiaries, or will be sold and net proceeds of sale will be distributed. Whatever the specific estate plan, forestalling the need to sell until after the deaths of the owners is a common goal of contemporary estate planning, now that each taxpayer's credit against federal estate tax covers estate value $11.18 million (minus earlier taxable lifetime gifts) in 2018, a number that will increase in 2019. The goal is often to maintain ownership of the real estate in a way that causes inclusion in the taxable estates of the seniors in order to bring about date of death valuation under Internal Revenue Code Section 1014. This can be done through outright ownership or in a trust that causes taxable estate inclusion.

A private family loan can enable properties to be maintained, even though the owners do not have sufficient personal income or savings to maintain the properties, and the owners are very likely not to qualify for commercial loans or lines of credit. A simple "demand promissory note" executed by the borrower (or by his or her agent under power of attorney with appropriate power pursuant to state law) transforms what otherwise would be construed to be a gift from the family member to the senior into a documented loan.

In states with Medicaid rules that allow an applicant to be eligible while still owning a home after he or she enters a nursing home and applies for Medicaid expressing "intent to return home," or an applicant owning "income-producing property," there still looms the threat of Medicaid estate recovery upon the death of the Medicaid recipient if an exemption does not apply, or if Medicaid estate recovery has not been avoided by the form of ownership or by divestment for title purposes to a properly drafted irrevocable trust. A prior, recorded private reverse mortgage deed and promissory note is a way for family lenders' financial support to the seniors to be secured by the collateral, with priority over any later Medicaid lien or estate recovery claim. When the property subject to the reverse mortgage gets sold, the reverse mortgage debt gets paid at the closing in the proper sequence of secured debts, prior to distribution of any net proceeds.

In summary, when family financial support of seniors is a solution for the seniors to remain in their homes, or to live wherever is appropriate (with other relatives, in assisted living, etc.) and when the planning timeframe or family circumstances make penalizable gifting strategies undesirable, structuring the family financial support as a formal loan documented by a promissory note is prudent, establishing a debt to the lender that can be paid back later when circumstances allow, without the payment to the lender constituting a gift for Medicaid or VA pension purposes.

If the borrower owns real estate, the loan can be secured by a private reverse mortgage in order to ensure the lender's right to be paid back upon sale of the real estate, before subsequent secured creditors and unsecured creditors, no matter whether the sale occurs during the borrower's lifetime or after death. This can be the key to enable the borrower to retain the property until death, allowing date of death valuation to be the cost basis for a subsequent sale, thereby minimizing federal capital gains tax and state income tax liability from the sale. ■