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Annuity rules and Medicaid

Lynn Brenner
Family Finance

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I am 70, retired and single. I have a fixed annuity purchased in 2002, which expires in 2007. I am collecting monthly interest from it. When it ends in 2007, I plan to re-invest with the same company. Does that mean that for Medicaid purposes the five-year look-back period begins in 2007 or when I first invested in 2002? With the new laws, is the annuity principal still exempt from Medicaid? (I have two daughters listed as beneficiaries on this asset.) I understood from a previous column that annuities worked the same as IRAs and that after age 70 1/2, if both IRAs and annuities were "in pay status," the principal was salvaged from Medicaid. Is this correct?
V.M., via e-mail

Yes and no. Medicaid treats an annuity like an IRA when it is held inside an IRA. Once you're taking annual IRA distributions that are required after age 70 1/2, the IRA is deemed "in pay status"; that means you don't have to spend the principal to qualify for Medicaid. But the "in pay status" rule doesn't apply to a stand-alone annuity - one not held inside a retirement account with mandated distributions after age 70 1/2. It sounds as if you own a stand-alone tax-deferred annuity from which you're taking interest, says Alan Kahn, a Syosset financial planner. This type of withdrawal is an option, although the interest is taxable when you take it out. What expires in 2007 is probably the surrender charge. Insurers typically levy this fee if you move your annuity to another company within a few years. A five-year surrender charge isn't uncommon, Kahn says, but in some cases the penalty period is seven or eight years.

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This type of annuity isn't sheltered from Medicaid claims because you still control the principal. There is a different kind of annuity that can shelter money from Medicaid, depending on when you bought it. That product is an "immediate-pay" annuity. With an immediate-pay annuity you give up access to your principal. In exchange you get monthly payments for a set period, which can range from a few years to the rest of your life. Part of each payment is interest, and part is return of principal. You could convert your deferred annuity into an immediate-pay annuity at the same company or a different company. But the Medicaid rules for these annuities aren't as generous as they used to be.

An immediate-pay annuity bought before Feb. 8, 2006, is sheltered from Medicaid, provided the annuity is irrevocable and can't be sold to a third party, says Bernard A. Krooks, a Manhattan elder-care lawyer. Your principal is sheltered from Medicaid claims, although monthly annuity payments must be spent on your care. At your death the annuity goes to any beneficiary you name. On Feb. 8, 2006, a new federal law changed those rules. Previously, investing in an immediate-pay annuity didn't delay your Medicaid eligibility. Now it does - unless you name Medicaid as your beneficiary. If you pick a different beneficiary, your investment is treated as a transfer of assets - and asset transfers made within five years of applying for Medicaid delay your benefits eligibility.

The duration of the delay is determined by dividing the amount you transferred by the average monthly cost of a nursing home. If you bought a \$100,000 immediate-pay annuity and the average monthly cost of a nursing home was \$10,000, your investment would delay your Medicaid eligibility by 10 months. The Medicaid look-back period starts the day you apply. If you buy an immediate-pay annuity and more than five years pass before you apply for Medicaid, the investment has no effect on your benefits eligibility.

Send questions to Family Finance, Business Desk, Newsday, 235 Pinelawn Rd., Melville, NY 11747-4250, or e-mail to Bfamfin@aol.com. Include your age, income and a list of major assets. Letters and e-mails can't be answered personally.

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