**The Chairman’s Corner**

**Parting Shots** | As I write this column I have just shy of three weeks to go as section Chair. It has been fun and it has been an honor. It has also been my second “go ’round” of the job. I therefore think it highly unlikely I’ll hold any other official position with the Elder and Special Needs Law section.

But that’s OK. We have a long custom of allowing former section chairs to weigh in. Or as I prefer to put it, “I can show up at the meetings, break some furniture, and go home.” Soon the former chairs’ society will outnumber the section council!

One of my goals as section chair was to try and open things up for “new blood.” In that regard, I think we did a good job . . . there are all sorts of good folks in place to be leaders of our little corner of the bar for years to come.

Here are a few random thoughts and suggestions, especially for those in the earlier stages of a career.

**Work Hard** | Running counter to just about every expert out there, I can’t say that I divide my life into “work” and “other.” I am an elder law attorney by day, and a spouse/father/friend by night. I am what I am, which involves many parts. In some sense I am always “on” and thinking about various work-related issues. On the other hand, various matters that aren’t career-related are never far off my screen. I may show up late and leave early, but I may also work all weekend. I can do that because I run my own firm. Of course, it also occurred to me that I also work harder than I ever did as a young associate.

The types of law we deal with are difficult (Medicaid, tax, trusts, and so on). So what? Learn it. Then master it. Make it part of you. Be grateful it is difficult; that’s why you don’t have much competition. Anyone reading this silly column can be a guru. Anyone. You just have to be willing to work at it. Hard.

**Continued on page 2**
Nothing will happen if you don't show up. And show up. And show up.

**Poke the Box** | One of my favorite authors and thinkers, Seth Godin, recently wrote a short little book called “Poke the Box.” I have ordered it for everyone who works with me, both here in North Carolina and Georgia. Get it.

A couple of threads run through Seth’s book. Be curious. Don’t just take things at face value. Wonder why something couldn’t be done a bit differently, then try it (“poke the box”). After you’ve handled the mastery thing (see above), make a habit of thinking “outside the box.” The difference between a good competent journeyman attorney and a master is (i) the amount of work expended mastering and (ii) the amount of time thinking outside the box.

**Develop a Sense of Humor** | The difference between a master getting by and a master with a big book of business is a sense of humor. Maybe that comes from spending time outside the box and developing a keen sense of irony. Don’t ever take yourself too seriously. And no matter how hard you worked, don’t forget that other people made it possible for you to get where you are.

**Get Involved** | Especially if you’re a newbie. One of the best ways to learn the law and pick up some interesting strategies is by hanging out with folks who do the same thing. One of the easiest ways to hang out with folks who do the same things is to get involved. With the section. With NAELA. With some group in your community (and meeting other related professionals).

Also, as I mentioned above, you got to where you are because of the efforts of other people. Getting involved is a way to pay it forward.

Keep in mind, no one is going to call you and ask, “Will you get please involved?” You’ll need to make that happen. Poke the box.

**Make Friends** | This may be most important. It occurred to me that many of my best friends are members of the North Carolina Elder Law section. Some of us will be great friends and confidants for the rest of our lives. You know who you are. I wouldn’t trade you for anything.

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The End, continued from the front page

used for analytics. Again, while not outwardly stated, the gathering of data is the first step to analyzing the ways that cuts can be made.

One of the most obvious cutbacks is included in version 7, section 12.H.18(b). This requires a 3% cut in state payment for a variety of programs, including for inpatient hospital stays, dental services, podiatry, and adult care homes. In the initial bill proposal, this also included nursing homes, but nursing homes were later struck from the bill. While not surprising, this will have a large impact on facilities which, in turn, will likely be passed on to our clients either by way of higher fees or fewer services or patients accepted. This cut also comes at a time when healthcare costs are rising at an average of 6% annually (http://kff.org/other/state-indicator/avg-annual-growth-per-capita/).

Also included is section 12.H.18(a) which provides for additional assessments on waiver services. This section states that, if federal law is amended to allow the imposition of assessments on 1915(c) North Carolina Innovations Waiver (CAP-MR/DD), then DHHS and DMA may implement an assessment program up to the maximum percentage allowed by federal law and up to 65% of the assessment may be retained by the state to support other Medicaid initiatives.

12.H.27(a) – Mediation in appeals. This section includes details regarding mediation on a contested Medicaid case. Mediation Network of North Carolina shall contact the enrollee within 5 days of notification of the request for appeal, to offer mediation. If mediation is accepted, and the enrollee fails to attend the mediation, then the case shall be dismissed. There is an exception for good cause but no definition. While this may not affect clients who are working with an attorney, this may affect those who are contesting pro se. Noted is the word “may” indicating that the individual is not required to accept mediation.

12.H.34 requires a reporting on the PACE program including expenditures and a comparison of the cost savings of PACE over the cost of caring for those same individuals in a nursing home. Until this information is gathered, it is difficult to speculate on how this would affect our clients. However, it is widely believed that PACE offers significant savings over nursing facilities due to certain unique feathers such as a reduced staff need (no overnight care or weekends), fewer meals, and lower building costs.

On a slightly more positive note, 12.H.35 of the bill allows for an individual who is receiving waiver services to move from one county to another. Specifically, “Section 1915(c) waiver slots shall be portable and recognized uniformly throughout all counties of North Carolina; an individual who receives an innovations waiver in one county shall be portable and recognized uniformly throughout all counties.” This section obviously allows individuals to move as appropriate rather than being imprisoned within their county.

While some of the above sections are disconcerting, I do not believe that these are surprising as the need for cuts has been widely publicized. However, version 3 of the bill was very alarming. Below is the text directly from the bill:

Adjustments to Medicaid Eligibility

SECTION 12H.3.(a) Effective January 1, 2015, the following adjustments are made to eligibility for the Medicaid Program:

(1) Categorical coverage for recipients of the optional state supplemental program State-County Special Assistance is eliminated.

(2) Coverage for the medically needy is eliminated, except those categories that the State is prohibited from eliminating by the maintenance of effort requirement of the Patient Protection and Affordable Care Act. Effective October 1, 2019, coverage for all medically needy categories is eliminated.

SECTION 12H.3.(b) It is the intent of the General Assembly to reduce optional coverage for certain aged, blind, and disabled persons effective July 1, 2015, while meeting the State’s obligation under the Americans with Disabilities Act and the United States Supreme Court decision in Olmstead v. L.C. ex rel. Zimring, 527 U.S. 581 (1999). No later than March 1, 2015, the Department of Health and Human Services, Division of Medical Assistance, shall submit to the House Appropriations Subcommittee on Health and Human Services and the Senate Appropriations Committee on Health and Human Services a draft waiver or other proposal that limits Medicaid coverage for the aged, blind, and disabled to the minimum required to meet mandatory requirements of the Medicaid program and the Americans with Disabilities Act. The Department may submit drafts of the waiver to the Centers for Medicare and Medicaid Services (CMS) to solicit feedback but shall not submit the waiver for CMS approval until authorized by the General Assembly.

In no uncertain terms did the senate bill propose to eliminate the only program available to assist people with adult care home (assisted living elsewhere) bills as well as medically needy programs which cover elderly and disabled individuals that would not be otherwise eligible for Medicaid. The cost of this care is prohibitive for many and its elimination would have dire consequences. Obviously not contemplated is the large gap that exists for those in need of some assistance (IADL or one ADL) and who have limited income and assets.

Other states such as Georgia and Virginia have little to no benefit for those with limited income and resources needing assisted living levels of care. In practicality, what happens is that those needing care are often placed into nursing care and doctors and nurses knowledgeable about programs assist in proper preparation of the required screening documents (FL-2). This very obviously increases the burden on nursing facilities and practically increases state funds expended because the same individuals are applying for Medicaid to cover nursing care expenses.

The alternative is that these individuals who are in need of assisted living remain at home. Because of their lack of assistance at home, they are more likely to have some sort of health crises as a result of a lack of assistance. I myself have seen hospital admitting for malnutrition, dehydration, medication mismanagement,
and complications arising from the underlying illnesses such as extremity amputations due to diabetes. In these instances, these individuals often end up in nursing facilities, by way of hospitals, earlier than they otherwise would have due to a lack of care.

Thankfully, the elimination of special assistance has been removed from later versions of the bill and the bill has yet to pass. However, I believe that this is a foreshadowing of events to come. Particularly since other states have made the same cuts. While it does not appear as if planning and assistance with Special Assistance has been eliminated, be vigilant as I believe it is likely to come.

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She is the current Treasurer of the North Carolina Bar Association Elder Law Section and is the former Editor in Chief of “Gray Matters,” the newsletter for the Elder Law Section of the North Carolina Bar Association. She is active on the Elder Law Section Councils for both the North Carolina Bar Association and the Virginia Bar Association. She is an active mentor for the North Carolina Chapter of the National Academy of Elder Law Attorneys and is an active member of the National Academy of Elder Law Attorneys.

Gray Matters
www.ncbar.org

North Carolina’s Programs of All-Inclusive Care for the Elderly

By Bailey Liipfert

Over the past several years, the State of North Carolina has become a big believer in Programs of All-Inclusive Care for the Elderly (PACE Programs). PACE Programs provide all types of care to persons 55 years of age and older who are at risk of nursing facility-level institutionalization. A typical candidate for PACE is frail, living at home, but at risk for losing independence due to medical complications and social isolation. Typically, PACE Programs are centered around an adult daycare program with greater service, such as bathing, supervision and therapy services, but all sorts of services may be covered by PACE, including respite in a nursing facility or even an assisted living facility or, at great cost to PACE Programs, long-term nursing facility stays. PACE programs also cover the cost of CNA-level care in the home. PACE is a cost-effective way to care for elders in their homes.

PACE Programs accept dual eligibles (people eligible for both Medicaid and Medicare) or Medicare-eligible persons able to pay Medicaid’s share of the cost privately. Private pay for PACE is one good asset spend-down option for future Medicaid recipients. Since the monthly payments are predictable, private pay PACE participants can more easily plan spend-down.

PACE participants on Medicaid have several benefits over nursing facility Medicaid eligible persons. First, the personal needs allowance for PACE is $973 versus $30 for the person eligible for Medicaid in the nursing facility. PACE participants keep the $973 per month even for the first 3 months of a nursing facility stay. This increases the odds that their home bills, like gas, electricity, mortgage or rent will continue to be paid during respite stays in facilities or for some time past Medicare days. Second, PACE participants who are married keep this increased personal needs allowance and their spouses can keep their community spouse income allowance as well, thus greatly increasing household income. Third, once eligible for PACE, participants enjoy a more relaxed standard for level-of-care. They may actually stay eligible for PACE when they would require only an adult care home level-of-care, but would be at high risk for nursing facility care but for the PACE services.

What’s not to like about PACE? PACE Programs do not yet exist in all counties or regions. Your clients may have to wait. Also, PACE Programs may be picky about the health conditions of applicants. Since PACE must cover whatever care needs arise for a participant, including long-term stays in nursing facilities, they have an incentive to cherry-pick the “best bet” applicants. Where can you learn more information? Check out the North Carolina PACE Organization website at www.NCPACE.org.

Bailey Liipfert III is a certified elder law attorney by the National Elder Law Foundation and is the Chairman of the N.C. Chapter of NAELA.

For more news you can use, visit elderlaw.ncbar.org
Special Assistance And Personal Care Services

By Aimee L. Smith

Special Assistance is an often misunderstood program. Many people, even some attorneys, and most of the people in the assisted living program, do not call it by its correct name. Special Assistance (SA) is not Medicaid. It is like fingernails on a chalkboard for me when clients tell me that they have been informed that the assisted living facility where they are moving accepts “Medicaid.” It creates issues because as most of us know, SA has an income limit. If you exceed the income limit ($1,247.50 for regular assisted living and $1,580.50 for special care units) by even one dollar, you do not qualify. Long-term care Medicaid does not have an income limit except that your income must be less than the cost of your care. We have had many clients over the years who spent their money privately paying for care in an assisted living facility that had assured them they could get ‘Medicaid’ when they ran out of money only to discover that it is not Medicaid that they need to apply for at all—and they do not qualify for SA. SA is a state program. Medicaid is a Federal and state program. They are two different programs. They are not interchangeable. The nutshell takeaway: Special Assistance is NOT Medicaid.

Now that we have established that SA is not Medicaid, let me further confuse you. Everyone who is approved for SA gets enrolled in Medicaid. Medicaid pays for the SA recipient’s Medicare premiums and co-pays as well as any medical expenses not covered by Medicare. However, Medicaid also pays part of the bill at the assisted living facility. This is something that I think a lot of us were not aware of. Many of us became aware of it in 2013 when the amount of services that Medicaid will pay for in assisted living facilities, particularly the special care units, was drastically cut.

Most of us believed that SA paid for assisted living. Period. The end. However, SA actually pays just for room and board. Medicaid pays separately for the personal care services (“PCS”) that the SA recipient receives in the facility. Think of it as the bill for college. You paid “x” amount for tuition and a separate amount for your dorm room and meal plan. It is the same concept with SA and Medicaid. SA is the gateway for Medicaid, though. You get the Medicaid as a result of being eligible for SA. If you are living in assisted living but you don’t qualify for SA, you are not going to be eligible for Medicaid.

The other thing that I want to point out about SA that some may not be aware of is that the income limit for SA is roughly the reimbursement rate that facilities receive for people on SA. For SA recipients in regular assisted living, facilities receive $1,182 for room and board. The state also pays the full cost of personal care services (“PCS”) that Medicaid pays for each month. I then understood how the problem had been fixed without increasing the income limit. I knew that many nicer facilities still either did not accept SA in their regular assisted living or accepted it but continued to require two years of private pay. I asked the administrator about PCS for regular assisted living. She told me that they received a little over $300 per month for PCS for regular assisted living.

The above described situation with PCS in SCU worked great for several years. Then in 2011, there was a lawsuit filed that alleged that the state was treating individuals living at home differ-
ently than those living in facilities when it came to PCS. The lawsuit came about as a result of the state limiting PCS provided in the home as well as restricting eligibility for PCS for individuals living in their home. The U.S. Department of Justice found that the state was operating its PCS program in a manner that perpetuates an institutional bias. In response to this, in January 2013 the state introduced the Consolidated Personal Care Services Program which set out the same eligibility requirements for PCS regardless of whether provided to someone living at home or in a facility, and also established that residents in facilities could not receive more hours than those living at home.

As a result of the Consolidated Personal Care Services program, the PCS hours provided to people in assisted living facilities were cut drastically. In addition, SA recipients started having to be independently evaluated in order to determine what PCS they would receive. Previously, the facility made this determination. The maximum number of in-home care hours available to someone living at home is 80 hours per month. After January 1, 2013, that also applied to people in facilities. There were a lot of appeals filed in early 2013 to maintain current level of services for SA recipients living in facilities.

As a result of the cuts to PCS hours, accepting SA residents into special care units again became an unattractive proposition for many facilities. Many that previously accepted SA in their SCU are now back to being private pay only. Other facilities have gone back to either requiring additional payments from family members or requiring the resident to private pay “x” number of years before applying for SA. I do not know of any regulation that prevents this practice. A memorandum dated January 29, 2013 suggests that facilities can bill additional amounts: http://www.ncala.org/Guidance-for-Family-Supplementing-Payment-to-Medicaid-Benefit-Memo-1-29-13.pdf.

An amendment to the North Carolina Medicaid State Plan adopted on May 19, 2014 should help to address some of the issues that were created in January 2013 by the Consolidated Personal Care Services Program rollout. State Plan Amendment (SPA) 13-009, authorized by N.C. Session Law 2013-306 (http://www.ncga.state.nc.us/Sessions/2013/Bills/House/PDF/H492v7.pdf) increased the maximum number of PCS hours from 80 to 130. To receive the additional 50 hours of PCS, the recipient must be determined to require that amount of hours based on an independent assessment and plan of care. Eligibility for the increased hours will require that a physician attest that the recipient requires: (i) an increased level of supervision; (ii) caregivers with training or experience in caring for individuals who have a degenerative disease, characterized by irreversible memory dysfunction that attacks the brain and results in impaired memory, thinking, and behavior, including gradual memory loss, impaired judgment, disorientation, personality change, difficulty in learning, and the loss of language skills; and (iii) regardless of setting, a physical environment that includes modifications and safety measures to safeguard the recipient because of the recipient's gradual memory loss, impaired judgment, disorientation, personality change, difficulty in learning, and the loss of language skills.

In addition, the recipient must have a history of safety concerns related to inappropriate wandering, ingestion, aggressive behavior, and an increased incidence of falls.

The above requirements were taken from a letter from Aldona Woz to CMS dated September 30, 2013. It can be found here: http://www.ncdhhs.gov/dma/plan/SPA13009_to_CMS.pdf. If you have a lot of time on your hands and you want to see our state plan and the actual updates to the plan, here is a link to the update letter related to this change: http://www.ncdhhs.gov/dma/plan/update1246.pdf.

In addition to increasing the number of hours available to 130, the rate per hour paid for PCS was decreased. The PCS hourly rate prior to October 1, 2013 was $15.52. From October 1, 2013 through December 31, 2013 it was $14.32 per hour. It is now $13.88 per hour.

It remains to be seen whether these changes will be enough to make accepting SA in the SCU attractive to facilities again. At $13.88 per hour for 130 hours, a facility would receive $1,804 per month in PCS dollars for a SCU SA recipient. When combined with the SA payment, that brings the total reimbursement to $3,319.40. This is roughly $500 less than what they received prior to January 2013 changes. Of course, $3,319.40 is $1,500-$3,000 less than the private pay rate at most facilities. Facilities may very well continue to try to get that difference from the families if there is nothing to stop them from doing so.

Anyone who has looked at the state Senate’s proposed budget knows that none of this may matter as of 2015 because the Senate budget proposes to eliminate the SA program altogether. If you think that is a bad idea, now would be the time to let your state senator know that the Special Assistance program is something that we need to keep.

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Ante-Mortem Probate: Considering a New Tool for Estate Planning in North Carolina

By Erin E. McKee

Suppose a client comes to you seeking to draft a new will. His health has been steadily declining over the past decade due to chronic illness. When his spouse died several years earlier, his daughter moved in with him to provide care, even helping to pay a nurse when she must be at work. Although a previous will split the estate equally between his three children, the client explains to you that he has not seen his two sons in years, and he would like instead to leave his entire estate to the daughter, who has sacrificed so much time and expense to care for him. How do you advise this client to avoid challenges to his will once he is gone? It seems likely that one or both of the sons would object to being disinherited, and in this situation, it would be easy for them to claim that their father’s poor health left him mentally incapacitated or that their sister pressured him into drafting a new will naming her as sole heir.

A Problem without a Solution

Traditional methods of pre-empting an imminent will contest are not ideal in every situation. Non-probate transfers of property, whether through a trust or an outright gift, are not a good solution for clients who need to maintain control of their property or keep some liquidity to plan for future expenses, and trusts can still be challenged for lack of capacity or undue influence. An in terrorem clause may not deter someone with nothing to lose, and such clauses are not always enforced if the challenger appears to be acting in good faith. Although self-proving wills give a prima facie case for proper execution, they are still subject to claims of fraud, forgery, and undue influence. Even a videotape of the will’s execution is not failsafe – for instance, when a testator’s physical incapacity could give challengers grounds to question their mental capacity, as well.

Ante-Mortem Probate: Four Steps to Preventing a Will Contest

Several states offer a means of avoiding messy post-mortem will contests by allowing a testator to establish the technical validity of a will – including testamentary capacity and freedom from undue influence – while the testator is still alive. The outcome of so-called living probate, pre-mortem probate, or ante-mortem probate proceedings is a declaratory judgment that the will is valid, preventing challenges to that effect once the testator has died. North Dakota, Ohio, Arkansas have all had statutes outlining the process of ante-mortem probate for decades, joined by Alaska in 2010.

Although there are minor procedural variations between states, here’s how ante-mortem probate generally works:

1. The testator executes a will.
2. The testator asks the court for declaratory judgment ruling that the will is valid.
3. Named beneficiaries and heirs apparent are given notice and the opportunity to contest the will.
4. If the court rules that the will is valid, it becomes effective upon the death of the testator and cannot be challenged on the grounds specified by the judgment.

A Fix for Post-Mortem Problems

Ante-mortem probate addresses several shortcomings of traditional post-mortem proceedings. To begin with, post-mortem will contests can be fueled more by the indignation of disinherited kin than legitimate concern that the deceased’s intent is not being honored. However, when the testator is alive to defend his or her intentions, would-be challengers may be deterred from bringing challenges that are spurious or self-serving. By preventing challenges that are without merit, ante-mortem probate protects the body of an estate from bearing the cost of a lengthy will contest. This means more of the estate goes to the actual beneficiaries of the will, ultimately preserving testamentary intent. As an added benefit, fewer of these challenges also mean less strain on the judicial system.

A major failing of the post-mortem system of probate is that challenges based on lack of capacity and undue influence are decided only once the best evidence for these issues – the testator him or herself – is permanently unavailable. Ante-mortem probate solves this problem by considering challenges related to the testator’s state of mind while the testator is still alive and available for examination. That way, when testamentary capacity or freedom from undue influence are challenged, the testator’s state of mind will not have to be reconstructed through the fallible memories of the interested parties – the testator him or herself is living proof.

From a planning perspective, ante-mortem probate provides a degree of certainty that the traditional post-mortem system cannot guarantee. In states without the option of ante-mortem probate, all available planning tools leave plenty of room for a will contest in situations like the one of our hypothetical client. Will validation through ante-mortem probate gives the testator the least likelihood of a will contest, leaving them with the peace of mind that their final plans are just that – final.

Theoretical Concerns

For all its obvious benefits, ante-mortem probate is not without flaws. When New York considered allowing ante-mortem probate in 2009, it concluded that the potential problems raised by the proceedings outweighed its advantages. In particular, the discussion centered around issues of proper notice to interested parties, interstate recognition of a will judged to be valid, family disruption due to the public disclosure of the will’s contents, and the potential suppression of legitimate challenges to a will for fear of offending
the living testator. However, common criticisms are more likely to be theoretical than actual. For instance, concerns about notice to unborn heirs raise the specter of the “fertile octogenarian,” and the problem of interstate recognition has not been challenged once in the long history of the ante-mortem probate statutes in North Dakota, Ohio, and Arkansas. Concerns over the potential for family disruption or the suppression of legitimate challenges hold some sway, but family squabbling is just as likely to occur in post-mortem will contests, and Alaska’s statute is an example of how proceedings can be arranged to allow for greater confidentiality.

A Tool Worth Trying

The process of ante-mortem probate does not replace anything – it simply provides those making their final arrangements with another tool to ensure those plans are carried out. In situations where a client seems particularly vulnerable to a challenge based on capacity or influence, it makes sense to be able to pre-empt those challenges while the testator is still around to do so. It is time for North Carolina to consider adding ante-mortem probate to its estate planning toolkit. In a state that so many older adults call home, such a measure would bring greater peace of mind to a large segment of our population – our clients, our families and ourselves.

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Case Developments

By Casey Ferri

T. Travis Medlock v. LegalZoom.com, Inc. (S.C., April 2014): The SC Supreme Court held that Legal Zoom, Inc. was not engaged in the practice of law. The Court held that almost all documents provided by Legal Zoom are self-help documents available on state government websites and that Legal Zoom only provides assistance in creating documents (as opposed to providing advice on them). Notably, this case was mentioned during a recent hearing in Legal Zoom, Inc. v. North Carolina State Bar (ongoing). Legal Zoom filed suit against the NC State Bar after receiving multiple cease and desist orders. In May, the NC Superior Court dismissed two counts in the suit that alleged that the NC State Bar violated anti-monopoly and equal protection clauses of the NC Constitution by attempting to shut the corporation down. However, the Court has deferred judgment on the unauthorized practice of law issue, instead asking the NC State Bar for specific issues to address against Legal Zoom, instead of a blanket statement.

Hull v. Sebelius (D. Conn., ongoing): The Center for Medicare Advocacy filed a class-action lawsuit in United States District Court in Connecticut on behalf of plaintiffs denied a meaningful review of Medicare claims for home health care coverage. The denial rate for home health coverage is increasing and is at about 98% at the first two levels of review, combined. Administrative Law Judges typically reverse 40% to 60% of those cases at the third level of review. The suit alleges that applicants are being wrongly denied coverage early on, and are therefore going without necessary care (or impoverishing themselves to pay for it) while waiting for their claims to make it before an ALJ. Further, most applicants lack the resources to pursue their claims all the way to the hearing stage with an ALJ, making the first two levels of review even more critical.

Senate Bill 744 (2014) and House Bill 1181 (2014): Senate Bill 744 was first sent to the House on 5/31/14. After drastic revisions in the House, Bill 744 is now back in the Senate for further revisions (in its 7th version). The original order that would have stopped the implementation of Medicaid reform and accountable care organizations has been deleted in the current version of Bill 744. The creation of a new state agency to manage Medicaid has also been deleted in the current version.

House Bill 1181 (approved by House Health and Human Services Committee in June 2014) calls for funds that Medicaid allocates for each patient to be capped in order to provide budget certainty. The House plan allows for medical providers to receive a fixed fee for each Medicaid patient that they treat by mid-2020. The medical providers’ profit (or loss) would therefore depend on their treatment of the patient and ability to keep the patient healthy. Conversely, the Senate Plan called for a network of insurance companies, as opposed to providers themselves, to take over the system. This Bill will go before Senate for review in coming weeks.


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Fun Trust Tricks With Adverse and Non-Adverse Parties

By Bob Mason

"Keep your friends close and your enemies closer" - Michael Corleone (The Godfather Part II)

Sound Familiar?

Greta Grantor wants to put her home into a trust to protect it from estate recovery in case she ever goes into a nursing home and onto Medicaid. At the same time she and her daughter agree that a time could come to sell the home and reinvest in an in-town condo. Grantor trust status is a paramount goal in order to preserve the tax free sale of the home, but Greta is very concerned about state Medicaid rules that could include any asset over which she has too much retained control.

Sam Settlor wants to move some assets to trust in order to qualify for VA benefits, yet he wants to insure that those assets receive stepped-up basis upon his death. Because the VA will likely question the existence of a grantor trust that generates tax activity that will show up on his Form 1040, avoiding grantor trust status is important. In spite of this concern he would still like to have some control over trust distributions and who may eventually inherit.

The answers for Greta and Sam might involve the intelligent use of people called adverse and nonadverse parties. Grantor trust status is achieved by the grantor retaining certain benefits or control mechanisms over trust assets (in this article these are called “Grantor Powers”). In many cases, however, a Grantor Power can be given to (or shared with) a nonadverse party without jeopardizing grantor trust status. On the other hand, a Grantor Power will not cause grantor trust status if it requires the cooperation of an adverse party, or if it can be blocked by an adverse party.

Who’s On Adverse?

An adverse party is someone with a beneficial interest in the trust that will be positively or negatively affected by the exercise or non-exercise of a certain power. For example, if Anthony has been given an income interest in a trust but Greta Grantor has retained a power to appoint the income interest, Anthony will be adverse with respect to that retained power of appointment. If Greta Grantor exercises her power to appoint the income of the trust, Anthony Adverse will be the loser.

The rules are simply based on an understanding of human nature and the propensity of an individual to act in his or her best interests during the course of navigating life’s many decisions. An adverse party is less likely to be subject to the influence of the grantor because she will be primarily motivated to take or withhold action to preserve her trust benefits. On the other hand, a nonadverse party is free of those motivations (“he doesn’t have any skin in the [trust] game,” so to speak, and is more likely to act at grantor’s behest). In fact, if trust design calls for the use of a nonadverse party, the grantor will look around for someone who is not a beneficiary and who will likely return the grantor’s phone calls (if not do exactly what the grantor wants done). Internal Revenue Code (“Code”) section 672 and the regulations thereunder recognize this very human tendency.

Unfortunately, nothing is as simple as it may seem.

A Deeper Look

Code section 672(a) defines an adverse party as “any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he possesses respecting the trust.” Subsection (b) simply defines non-adverse party as anyone who is not adverse.

As usual, the regulations flush it out a bit, and that is where things become more interesting. If an individual is not a beneficiary, she will not be an adverse party.1 On the other hand, it does not always follow that a trust beneficiary will be adverse. The regulations spell out a couple of examples.

Example

An individual can be adverse with respect to a portion of a trust only. Say a trust provides an income interest of three equal shares to Anthony, Betty and Charlie. Greta Grantor, however, has reserved a right to appoint the income interest to the North Carolina Zoological Park with the consent of Anthony. This is a Grantor Power because Code section 674(a) provides that a grantor will be the deemed owner of any portion of a trust over which he has retained a power to affect the beneficial enjoyment thereof, without the consent of any adverse party.

If you are paying attention, you must be thinking, “Wait, Anthony is adverse so how can this be a grantor trust?” You are half right (er . . . one-third right). Anthony is adverse with respect to Greta’s retained power of appointment, but only with respect to one-third (1/3) of the income of the trust. Anthony is nonadverse with respect to the other two-thirds of the income. In this particular case, the trust would be a grantor trust with respect to two-thirds of the income and a non-grantor trust with respect to a third.2 After all, Anthony’s interests are not at all affected by the appointment of what would have been Betty and Charlie’s shares. He is, however, keenly interested in his one-third of the income.

In that case, two-thirds of the items of income, deduction or credit allocable to trust income under the terms of the trust agreement or the North Carolina Uniform Principal and Income Act will be deemed to be Greta’s and will appear in some form or fashion on her Form 1040. The trust will need to report the tax attributes allocable to one-third (1/3) of the trust corpus on its own Form 1041.

Yet another riveting example

A trust provides an ordinary income interest to Adella Adverse...
with a power in Adella to appoint the trust principal to Sam Settlor either during Adella’s life or upon Adella’s death with a testamentary power of appointment. Any capital gains are to be added to trust principal. In this particular case, Adella’s power is adverse to Sam to the extent that Adella can appoint the corpus during her life (after all, Adella’s income will be wiped out if she appoints the principal to Sam). In that case the ordinary trust income will not be reportable on Sam’s Form 1040 because the ordinary income can be controlled by Adella Adverse. Rather, the income will be reportable on the trust’s Form 1041.

But wait . . . Adella’s power to appoint corpus to Sam upon Adella’s death will result in capital gains making an appearance on Sam’s Form 1040 because IRC section 677 says that any taxable income (capital gains is taxable income, after all) that could be accumulated for later distribution to grantor results in grantor trust status with respect to that trust portion. In this case, Adella (presumably) couldn’t care less what happens to trust income after her death which renders her nonadverse with respect to Sam and that specific trust portion. In this case, a nonadverse party (Adella) has the Grantor Power to accumulate income for potential later distribution to the grantor (Sam).  

A Potential Trap

The Regulations flatly state “[t]he interest of a remainderman is adverse to the exercise of any power over corpus of a trust, but not to the exercise of a power over any income interest preceding his remainder.” This exposes a common planning trap.

The Code and Regulations say that a testamentary power of appointment does not in and of itself create a grantor trust. If, however, income is accumulated “in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party” for later testamentary distribution by the grantor, then a grantor trust will be the result.

Because capital gains is most often not distributed, but rather added to corpus under the terms of the trust or the state principal and income act, it follows (one would think) that a retained testamentary power of appointment will create a grantor trust with respect to trust principal because income is being added to corpus for later disposition under grantor’s will. But not so fast.

Many attorneys think they have locked in grantor trust with respect to principal (let’s say they want to insure favorable capital gains treatment under Code section 121) by simply adding a testamentary power of appointment (realizing that capital gains are being added to principal and thus satisfying the regulation). Here is the catch: The same attorneys may also add a provision in the trust distributions terms that principal may not be distributed to grantor, but may be distributed to some class of other beneficiaries within the discretion of the trustee or some other parties. These sorts of provisions are added to allow some mechanism to strip principal out of the trust without creating potential Medicaid availability issues for the grantor.

If the consenting trustee or other consenting parties are from the pool of trust remainder beneficiaries, those consenting parties will be adverse. Because these adverse parties have control over distributions of principal, it follows that any accumulated capital gains added to corpus will be distributed via grantor’s will only with the tacit consent or approval of adverse parties. These consenting parties may simply elect to distribute the entire trust prior to grantor’s death.

In this particular case, if grantor trust status with respect to trust principal is important, look for some provision other than a testamentary power of appointment if any adverse parties have the ability to distribute corpus prior to the grantor’s death. Possible solutions might involve subjecting discretionary distributions of trust principal to the discretion of a nonadverse party or allowing grantor or a nonadverse party to add or delete remainder beneficiaries (both of which are Grantor Powers under Code section 674(a)).

For example: Greta Grantor retains a testamentary power of appointment over trust corpus. Under the trust instrument and local law capital gains are added to principal. Greta’s son Anthony Adverse, the trustee and one of the named remainder beneficiaries, has the discretionary authority to distribute principal to or among Greta’s issue. Greta’s testamentary power of appointment is not a Grantor Power because an adverse party can at any time prevent the accumulation of income for later testamentary distribution simply by ordering a distribution of principal.

OK, Another Example: The facts are as above, except that trust principal may not be distributed during Greta’s life. Greta’s testamentary power renders the trust a grantor trust with respect to all items of income, deduction and credit allocable to corpus (i.e., capital gains) because income is being accumulated for later testamentary distribution by Greta.

On the other hand, for some reason Greta does not trust herself with a testamentary power in her later years. The trust contains a “default” provision that on Greta’s death the remainder will be distributed per stirpes among Greta’s issue. But she also trusts her sister Nancy Nonadverse to respond to changing circumstances, so she provides that Nancy may order discretionary distributions of principal among Greta’s issue at any time. Nancy’s power is a Grantor Power under Code section 674(a) and is held by a nonadverse party, thus rendering the trust grantor trust with respect to all items of income, deduction and credit allocable to corpus.

Isn’t This Marvelous!

By wisely identifying available potentially adverse and nonadverse parties in the grantor’s universe, and by carefully designing trust provisions to meet grantor’s needs, a drafting attorney can control the tax status of the trust. This remarkable accomplishment will insure hero status in the client’s eyes and could very well be the stuff of later legal legend.

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1. Treas. Reg. § 1.672(b)-1 (the regulation reads in its entirety: “A ‘nonadverse party’ is any person who is not an adverse party.” Certainly this must put it in the running for the shortest tax regulation.)
2. See Treas. Reg. 1.672(a)-1(b).
4. Treas. Reg. § 1.672(a)-1(d).
5. Treas. Reg. § 1.674(b)-1(b)(3).
6. Id.
8. Id.
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