Personal Services Contracts Avoid Medicaid Conflict

Due to the recent economic downturn, I have begun to see a dangerous trend among my clients seeking long term care planning advice: Gifting. Parents have been called upon to help out their economically strapped children. Usually the parents gift their children some money to help make ends meet. This ends up being very taxing on the parent's funds especially if they are seniors living on fixed incomes and diminished assets.

What makes this a bigger problem is that most seniors do not have long term care insurance and will have to rely on Medicaid to fund a long term care event. Medicaid penalizes applicants for gifts made during the "look back" period. This period is currently three years prior to application for benefits (soon to become five years prior to application). The amount of all gifts made during the "look back" period are totaled and then divided by $5,000 (the Florida average cost for a month of nursing home care). The resulting number is the number of months that the applicant cannot get benefits from the time of application. Thus, any gifting by a senior who later needs Medicaid may result in some period of disqualification for Medicaid benefits later. Gifts between spouses or to a disabled child do not count.

Before you jump to conclusions and blame the seniors for poor planning, consider these facts. One half of all seniors make less than $25,000 a year and cannot afford long term care insurance. Of all applicants between the ages of 65 and 75, 28 percent are denied long term care insurance policies due to pre-existing health conditions. Of applicants between the ages of 75 and 85, the percentage of denials jumps to 48%. While long term care insurance has its time and place, a large number of seniors simply cannot afford it or even qualify for it.

So how do we help seniors who wish to help their children (preventing foreclosures, bankruptcies and increases in public aid)? The solution is a "personal services contract". A personal services contract is an agreement between the senior and their child for the child to perform health care and financial management services on behalf of the senior for the remainder of the senior's life. In return the senior can transfer a lump sum to the child based on the number of hours a week that the child will perform these services and the life expectancy of the senior. An hourly rate is calculated below what a similar health care worker would charge for these services. Once the sum is calculated, the monies can be moved to the child in return for the child performing the contractual services. Since this is payment for a service, the transfer is no longer a gift and thus does not run afoul of the "look back" period. However, since it is payment for a service, it is treated as ordinary income to the recipient for income tax purposes. Also, the child must keep time records.

In sum, there is a right way and a wrong way to help out your children. Simple gifting will more than likely make you ineligible for Medicaid later on. If you have long term care insurance or can self insure, this is not a problem. However, if you might need Medicaid to help pay the bill, consider a personal services contract.