What You Need to Know About Lopes v. DSS

On October 2, 2012, the U.S. Court of Appeals in the Second Circuit ruled that the payment stream from a community spouse's non-assignable annuity is not a resource for purposes of determining Medicaid eligibility. Lopes v. Department of Social Services, 696 F3d 180, 2012 WL 4495500, Case No. 10-3741-cv (Oct. 2, 2012)("Lopes v. DSS"). This case requires all Connecticut elder law attorneys to consider purchasing an annuity to qualify a couple for Title 19.

John Lopes, age 85, lived in the Riverside Manor Health Care Center in East Hartford, Connecticut. Lopes v. Starkowski, 2010 WL 3210793, Civil Action No. 3:10CV307(JCH)(D. Conn. 2010)[Ruling Re: Plaintiff's Motion for Summary Judgment and Defendant's Cross-Motion for Summary Judgment] (hereinafter "Lopes District Court Decision") at 1[cites are to WestLaw version, not to the original opinion]. John's wife, Amelia Lopes, lived in their home in East Hartford, Connecticut. As of February 5, 2010, the couple had assets in excess of $340,000. Lopes District Court Decision at 1. John had a Connecticut partnership long-term care policy which paid $71,175 for his care through February, 2010. Id. Amelia had to spend down her assets to $180,735 for her husband to qualify for Medicaid. Id. This amount was the sum of the Community Spouse Protected Amount (CSPA) in 2010 ($109,560) plus Connecticut partnership policy payments ($71,175). On February 18, 2010, John filed a Medicaid application with the Connecticut Department of Social Services. Lopes v. DSS at 183. Amelia purchased an immediate single premium annuity with a 6-year term for $166,878.99 from The Hartford, a life insurance company. Lopes v. DSS at 183.

The Assignment Limitation Rider to The Hartford annuity contract states:

This contract is not transferable. The rights, title and interest in the contract may not be transferred; nor may such rights, title and interest be assigned, sold, anticipated, alienated, commuted, surrendered, cashed in or pledged as security for a loan. Any attempt to transfer, assign, sell, anticipate, alienate, commute, surrender, cash in or pledge this contract shall be void of any legal effect and shall be unenforceable against us [The Hartford]. Lopes v. DSS at 183.

The Hartford confirmed by letter dated March 9, 2010, that "neither the annuity contract nor any periodic payments due thereunder can be cashed in, sold, assigned, or otherwise transferred, pledged or hypothecated [due to the Assignment Limitation Rider]." Lopes v. DSS at 183. Dan Butler, principal attorney for DSS, identified Peachtree Financial Services ("Peachtree") as a potential buyer for the income stream from Amelia. Lopes District Court Decision at 1. In a letter dated April 16, 2010, Butler directed Amelia to sell the income stream, attaching information from Peachtree. Id. Although Peachtree appears to have been willing to purchase the annuity for approximately $99,000, Amelia maintained that the annuity contract was a fixed income stream, not an asset she was required to liquidate. Lopes v. DSS at 183. On May 18, 2010, DSS denied her husband's Medicaid application on the grounds that Amelia failed to cooperate in liquidating a potentially available asset. Lopes v. DSS at 183; Lopes District Court Decision at 2.

John Lopes filed suit claiming that the Connecticut UPM §4030.47 was more restrictive than SSI regulations. Lopes v. DSS at 183. Federal statute 42 USC §1396a(a)(10)(C)(i)(III) prohibits states from using a methodology that is more restrictive than that used by the SSI program. Lopes argued that Conn. UPM §4030.47 defines the term "asset" more broadly than the SSI program does. Lopes relied on the SSI Program Operations Manual System ("POMS"), which clarifies that an asset is only a resource if the applicant has the legal right, authority or power to liquidate it. Lopes v. DSS at 183 citing POMS §SI 01110.115 (effective Jan. 15, 2008).

The federal district court ruled in favor of Lopes. The Court held that treating the income stream as an asset was more restrictive (admits less applicants) than would be applied to a similarly situated individual under the methodology utilized by SSI. Lopes District Court Decision at 4. John Lopes also claimed that the Connecticut UPM §4030.47 violates 42 USC §1396r-5(b)(1) because it counts the community spouse's income from the annuity as an available asset in determining eligibility for Medicaid. The federal statute 42 USC §1396r-5(b)(1) states:

During any month in which an institutionalized spouse is in the institution, except as provided in paragraph (2), no income of the community spouse shall be deemed available to the institutionalized spouse.

This is “the MCCA rule.” MCCA is an abbreviation for the Medicaid Catastrophic Coverage Act of 1988. The provisions of paragraph (2) referred to in the MCCA rule (i.e. - §1396r-5(b) (2)) are the income attribution rules between spouses. The Court stated that it would be incongruent with the principles of MCCA to permit a state to characterize even an assignable income stream as an asset. Lopes District Court Decision at 10. Allowing DSS to treat an income stream from an annuity as an asset “would open the door to states recharacterizing other income sources as assets, such as “payments tied to a fixed income account, social security, or even a regular paycheck.” Id., citing James v. Richman, 547 F.3d 214, 219 (3rd Cir. 2008).

The Second Circuit Court noted that the Assignment Limitation Rider strips Lopes of both (i) the right to assign her payments under the annuity by providing that the rights, title and interest in the contract may not be transferred, and (ii) the power to assign her payments by providing that any attempt to transfer, assign or cash in the contract shall be void of any legal effect. Lopes v. DSS at 185 citing Rumbin v. Utica Mut. Ins. Co., 254 Conn. 259, 757 A2d 526,535 (2000). The Court pointed to POMS §SI 01110.115 as entitled to substantial deference:

Assets of any kind are not resources if the individual does not have:

- any ownership interest; or
- the legal right, authority, or power to liquidate them (provided they are not already in cash); or
- the legal right to use the assets for his/her support and maintenance.

Lopes v. DSS at 186. DSS contended that SSI regulation 20 CFR §416.1201(a)(1) controls over the POMS guidelines. That regulation states:

If the individual has the right, authority or power to liquidate the property or his or her share of the property, it is considered a resource. If a property right cannot be liquidated, the property will not be considered a resource of the individual (or spouse).

20 CFR §416.1201(a)(1). DSS argued 20 CFR §416.1201(a) (1) only requires the applicant be able to liquidate the property; it does not require the applicant to be able to liquidate the property without incurring legal liability. Id. at 186. DSS also argued that the payment stream from the annuity contract qualifies as a resource because Lopes could sell it without assigning her rights by simply signing a separate contract promising to pass each payment along to a third party. The Court was not persuaded by these arguments. A Medicaid applicant could make a similar agreement regarding any source of income: pension checks, railroad retirement annuities, or even the applicant’s weekly income from a current job. Id. at 187. The Court agreed with the Third Circuit that “under a theory permitting an annuitant to sell the income stream, there is no clear limit on the hypothetical transaction proceeds that could be treated as assets, whether based on the sale of a future stream of payments tied to a fixed income retirement account, social security, or even a regular paycheck.” Id. at 187 citing James v. Richman, 547 F.3d 214, 219 (3rd Cir. 2008).

The Court also found it reasonable for the POMS guidelines to specify that liquidation of property must not only be physically possible, but also otherwise permitted by law, in order to qualify the asset as a resource under MCCA. Without such a clarification, a Medicaid applicant could be required to liquidate such assets as her right to pension payments or property of which she was the trustee. Id. at 187.

DSS contended that the owner of a non-assignable annuity has the right, power and authority to liquidate the property as long as there is a prospective purchaser (like Peachtree) for the payment stream. Id. at 185. The Court noted, however, that 20 CFR §416.1121 classifies payments from annuities, private pensions, social security benefits, disability benefits, veterans benefits, worker’s compensation, railroad retirement annuities and unemployment insurance benefits as “unearned income” without regard to the existence of a prospective purchaser. Id. at 185. The Court held that these income sources are analogous to Lopes’ annuity in both their payment structure and their non-assignability. Id. at 185. Consequently, non-assignable annuities should also be treated as income.

DSS pointed to additional SSI regulations that say if an individual liquidates a resource before applying for benefits, the proceeds are still a resource. Id. at 185. For example, 20 C.F.R. § 416.1207(e) provides: “If an individual sells, exchanges or replaces a resource, the receipts are not income. They are still considered to be a resource.” 20 C.F.R. § 416.1207(e). In particular, DSS contended that Lopes’s annuity qualifies as a resource under these regulations because Lopes converted her excess resources into a non-assignable annuity shortly before she sought benefits. Id. at 185 - 186.

The Court dismissed these additional SSI regulations saying they only stand for the proposition that if you convert a resource to cash it remains a resource. The regulations do not establish that an annuity is a resource because it was in the form of cash shortly before applying for Medicaid. Id. at 186. Indeed, how recently assets were purchased does not matter in determining whether they should be excluded from the relevant pool of resources. Id. at 186. Accordingly, that Lopes converted cash to an annuity shortly before applying for Medicaid was irrelevant to whether the annuity, in its current form, qualified as a resource under the applicable SSI regulations. Id. at 186.

DSS also argued that the payment stream from the annuity contract qualifies as a resource because Lopes could sell it without assigning her rights by simply signing a separate contract promising to pass each payment along to a third party. The Court was not persuaded. A Medicaid applicant could make a similar agreement regarding any source of income: pension checks, railroad retirement annuities, or even the applicant's weekly income from a current job. Id. at 187. The Court agreed with the Third Circuit that "under a theory permitting an annuitant to sell the income stream, there is no clear limit on the hypothetical transaction proceeds that could be treated as assets, whether based on the sale of a future stream of payments tied to a fixed income retirement account, social security, or even a regular paycheck." Id. at 187 citing James v. Richman, 547 F.3d 214, 219 (3rd Cir. 2008).

The Second Circuit also gave special weight to the views of the U.S. Department of Health & Human Services ("HSS"). The Court requested that HHS file an amicus curiae brief in the case. HHS maintained in its brief that: (1) the "natural reading of . . . [§] 416.1201, as clarified in POMS § SI 01110.115, is that [the Social Security Administration] will not require an applicant to renegotiate or, possibly, breach a contract in order to recover the value of a resource, such as a non-assignable annuity, in order to qualify for Medicaid;" and (2) Lopes' retention of the annuity payment stream is not inconsistent with the primary purposes of the Medicaid statutes as modified by the Deficit Reduction Act of 2005 ("DRA"), which are to provide health care for the indigent and protect community spouses from impoverishment while preventing financially secure couples from obtaining Medicaid assistance. Lopes v. DSS at 184. The DRA contains disclosure requirements and requires that State be named as a beneficiary. Id. at 188. That the DRA has disclosure requirements for irrevocable annuities but does not categorically classify them as resources or designate their purchase as an impermissible transfer of assets, supports HHS's view that Congress has not demonstrated an intent to exclude all annuity payment streams from being treated as income. Id. at 188 citing James v. Richman, supra, at 219.

Of note, in the Second Circuit, DSS abandoned its claim that the DRA allowed the states to treat immediate annuities purchased by a community spouse as an asset for eligibility purposes. Lopes v. DSS at 183 - 184. A majority of courts have found that an unassignable annuity is not subject to treatment as an asset even after the passage of DRA. Lopes District Court Decision at 11.

At the end of its decision, the Second Circuit noted that in finding that the payment stream from a non-assignable annuity is not a resource for purposes of determining Medicaid eligibility, the Court has joined its sister circuits that have addressed this issue. It cited James v. Richman, supra (3d Cir.2008), Morris v. Oklahoma Dept. of Human Services, 685 F3d 925(10th Cir 2012), and Hutcherson v. Arizona Health Care Cost Containment System Administration, 667 F3d 1066 (9th Cir. 2012) as support for its decision. Lopes v. DSS at 188 – 189.

This Second Circuit opinion will directly affect Medicaid planning. It confirms that a community spouse can purchase an irrevocable, nonassignable, immediate annuity to lower the couple's countable assets. The 90-day appeal period for this case has run without DSS appealing this decision to the US Supreme Court. Thus, it is binding precedent. DSS has issued a Memorandum to its district offices stating that non-qualified immediate annuities that are non-assignable, irrevocable and name the State as a beneficiary are now treated as income instead of as countable assets. See, Memo from Mark C. Shok to DSS-DL-Eligibility Staff dated 10/12/12, a copy of which is available at www.ctnaela.org [1]. All annuities in a Medicaid application will continue to go to Dan Butler to confirm they meet the requirements of Lopes v. DSS, DRA, and DSS regulations unaffected by Lopes v. DSS. Id.

Below is a summary of how to purchase an annuity based on *Lopes v. DSS.*

1. Have the Community Spouse (CS) buy the annuity after the date of institutionalization and after the exhaustion of a Connecticut partnership long-term care insurance policy but before applying for Medicaid.
2. Buy an immediate annuity, not a deferred annuity.
3. Pick a term for the annuity that does not exceed CS's life expectancy based on the Social Security Tables in the POMs (the Period Life Table at www.ssa.gov/OACT/STATS/table4c6.html [2].
4. Confirm the amount invested in the annuity does not exceed the (i) the value of the couple's countable assets minus (ii) the Community Spouse Protected Amount (CSPA) plus any long-term care insurance payments made under a Connecticut

partnership policy.
5. Insist on a rider to the annuity contract that states the annuity and all payment under it are irrevocable and non-assignable. Use the language from Lopes case.
6. Confirm the annuity has equal installments and no balloon payments.
7. Make sure the annuity is actuarially sound. To be actuarially sound, the entire principal plus interest must be distributed within the life expectancy of the CS.
8. Name the State as a beneficiary to the extent of medical assistance paid.
9. Disclose the annuity on the Medicaid application.
10. Get a letter from the life insurance company confirming that it cannot be sold. Use the letter in the Lopes case as a template. See a copy at www.eldersolutionscenter.com [3] under Resources.
11. Refuse a request by DSS to sell the annuity to an annuity settlement company.

Figure 1.1 How to Purchase an Annuity to Reduce Countable Assets for Medicaid Eligibility

Practitioners should consider several factors when deciding whether to use an immediate annuity to qualify for Title 19 when the couple has assets exceeding the CSPA:

(i) Does the community spouse need additional income? Can illiquid assets be sold and converted to an annuity?

(ii) The age and health of the community spouse. An immediate annuity is uneconomic if the spouse will not live to the end of the term.

(iii) Does the couple have other exempt assets in which they can invest their funds such as a home or a car or a wheel-chair van?

(iv) Are there significant imminent cash needs that an immediate annuity will thwart?

(v) Does the community spouse have a large retirement account available for purchasing an immediate annuity instead of purchasing a nonqualified immediate annuity with countable assets? DSS acknowledges that immediate annuities inside a retirement plan ("qualified annuities") are non-countable assets.

(vi) Would a fair hearing to enhance the CSPA beyond the current limit (lesser of ½ of spousal assets as of the date of institutionalization to a maximum of $115,920 as of 2013) provide a more predictable solution without having to name the State as a beneficiary?

In the group discussion of this case at the CT-NAELA seminar "Practical Tips in Elder Law" held on October 19, 2012, participants noted that few insurance companies offer non-qualified spousal immediate annuities with the required restrictions. Some of the companies who offer spousal immediate annuities include The Hartford, Phoenix Life and Annuity Company, Penn Mutual, Northwestern Mutual and Nationwide. Most of them have a minimum term for an immediate annuity such as 5 years. The challenge for elder law attorneys will be creating a market for these annuities in light of this seminal case.

This article was originally published in The Connecticut Chapter of the National Academy of Elder Law Attorneys Practice Update, Winter 2013. Joseph A. Cipparone is a Principal in the law firm of Cipparone & Zaccaro, PC, in New London, CT. He is the author of Annuities in Connecticut Estate Planning, published by LawFirst Publishing of the Connecticut Bar Association.

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[1] http://www.ctnaela.org [2] http://www.ssa.gov/OACT/STATS/table4c6.html [3] http://www.eldersolutionscenter.com