ELDRS Update

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Early Registration Ends Soon for ELDRS 2017 Fall Conference

ELDRS Annual Meeting at 12:30 p.m., Thursday, October 5

By Angela M. Hentkowski, Steward & Sheridan PLC, Ishpeming

Discounted pricing for registration ends September 1, 2017. The last day to register on-line is September 25. After that, you will only be able to register on-site.

This year's Fall Conference will be held October 4-6 at DoubleTree by Hilton Hotel in Bay City. To register, check Events at www.michbar.org/elderlaw. To reserve your room, click here. Find the hotel in Bay City, and use the group code "ELD" to get the discount. Rooms are limited.

The keynote speaker this year will be Blaine Brockman. Attorney Brockman is a passionate advocate for improving the quality of life for people with special needs and the elderly. He is a member of the National Academy of Elder Law Attorneys (NAELA) and the Academy of Special Needs Planners (ASNP). He is also a member of the NAELA Special Needs Law Steering Committee and the Trusts and SNT Steering Committee. He currently serves as Vice Chair of the Ohio State Bar Association's Elder and Special Needs Law Committee and is very involved locally, serving on the Community Housing Network (CHN) in Columbus, Ohio. CHN provides permanent supportive housing for people with severe mental illness and others at-risk of homelessness. Brockman also serves on the Board of Advocacy and Protective Services, Inc., a non-profit corporation dedicated to protecting the rights of people with developmental disabilities by providing guardianship and protective services. Additionally, Brockman serves as treasurer of the board of Creative Housing, an organization that provides housing in central Ohio for people with developmental disabilities. He also served for 12 years on the Madison County Board of Developmental Disabilities, and recently joined the board of the ARC of Ohio.

At this year's conference, there will be both intermediate sessions and advanced sessions, as well as presentations by ELDRS' own experts, including a special plenary session presented by Doug Chalgian of Chalgian & Tripp Law Offices, PLC. There are more opportunities for elder law

attorneys to expand into litigation, and Chalgian will talk about why you might want to make the leap, stating there is romance and magic to litigation that is rewarding in its own way.

Legislative Update

By Todd Tennis, Capitol Services, Inc.

Legislature Passes Budgets, Breaks for Summer

This was the most rancorous budget process in years, as legislators and the governor hotly debated issues that would have a major impact on the state's bottom line. The Michigan House tried to reduce the Michigan Income Tax and set aside funds to pay for it. When that effort was unsuccessful, both the House and Senate set aside even more funds with the hope of closing the public school pension system (MPSERS). This would have led to potential large cuts in areas important to Gov. Snyder, such as the Dept. of Corrections and the Dept. of Health and Human Services. Legislative leaders and Gov. Snyder wrangled all the way into June before finally settling on a compromise.

In the end, the Legislature adopted school pension reforms that were less costly to the state by nearly $300 million. Those extra dollars were then placed back into the 2018 budget which was largely returned to the governor's original proposal. Major cuts to areas like prisons and long-term care were alleviated, and the governor's recommendation for funding increases were largely restored.

Key line items important to ELDRS saw moderate increases. These include the Senior In-Home Care Services line item, which will receive an additional $2 million, and Senior Meals and Nutrition Services will receive an additional $3.2 million. The Program for All-Inclusive Care for the Elderly (PACE) received an increase of $18.4 million which will be used to provide two new service areas (Newaygo and Central Michigan), and to increase available slots to cut down waiting times for applicants.

The Centers for Independent Living initially were on the chopping block as the budget came out of the House, seeing funding cut from $12 million to $4.5 million. However, the Senate restored it, and the final budget keeps them at $12 million. One program that did not manage to be restored is the Alzheimer's Care and Support pilot which lost its $150,000 in funding.

Another major point of contention was the future of behavioral and physical health integration. Last year, the governor proposed to shift funding for behavioral health to health plans. After a series of work groups and intense lobbying from mental health advocates, that change slowed down. For the 2018 budget, boilerplate language calls for pilot projects that will take place in Kent County and up to three other sites yet to be determined. In these pilot projects, single

contracts between the state and each local, licensed Medicaid health plan will be used to integrate behavioral and physical health payments. The department is also required to retain an independent project facilitator to establish performance outcome metrics and provide oversight.

In non-budget related legislation, the House passed by a 106-1 margin legislation to implement a Physician Order for Suitable Treatment form in Michigan. In lobbying circles, 106-1 constitutes what we call a "good vote." The legislation, contained in House Bills 4180, 4181, 4183 and 4184, was referred to the Senate Health Policy Committee where it will hopefully be taken up when the Legislature returns in the fall. Sen. Mike Shirkey (R-Clarklake) chairs the Senate committee, and we will try to schedule a meeting with his office over the summer to discuss ELDRS support for the bills.

On the political front, Lt. Gov. Brian Calley took many by surprise in June when, instead of announcing his bid for governor in 2018, he announced the creation of a campaign to create a part-time legislature. Attorney General Bill Schuette has also not officially declared his candidacy, but Lansing insiders still expect both he and Calley to be the major contenders in the Republican primary. On the Democratic side, Gretchen Whitmer, who announced her candidacy in January, continues to dodge serious potential Democratic rivals. Congressman Dan Kildee (D-Flint) declared in May that he would not run for Governor in 2018, and another well-known figure, attorney Mark Bernstein, did the same in July.

U.S. Sen. Debbie Stabenow (D-Lansing) is running for re-election against what may be a crowded Republican Primary. In addition to Lena Epstein (former Trump campaign leader), and Robert Young (former Michigan Supreme Court Justice), Detroit businessman and army veteran John James has filed an exploratory committee. Of course, the most famous person mulling a Senate run is musician Kid Rock, who would hope to follow the Trump formula to victory. In fact, the conventional wisdom in Lansing is that Mr. Rock would have the best shot of the above listed in winning the Republican primary, and possibly becoming Sen. Rock. After the outcome of the 2016 campaign, nothing seems impossible anymore.

How to Secure the DRA's Promissory Note Safe Harbor

By Robert C. Anderson, Brogan & Yonkers, P.C., Marquette

As part of the Deficit Reduction Act of 2005 (DRA), Congress tried to resolve Medicaid annuities and promissory notes. By enacting bright-line safe harbor rules, Congress intended to curtail the use of sham annuities and promissory notes while allowing those that complied with the new safe harbor requirements. The legislature intended these bright-line rules to provide more certainty for Medicaid applicants and Medicaid agencies in the use and evaluation of annuities

and promissory notes. It certainly was not Congress's intent to eliminate them. On July 21, 2017, the Wisconsin Medicaid agency issued DMS Operations Memo 17-34, which overruled a 2015 Wisconsin state law, Act 55, mandating that all promissory notes must be revocable. Wisconsin Act 55 deviated from the language in the DRA's promissory note safe harbor. This action was based on informal advice from the Centers for Medicare and Medicaid (CMS).

The advantages of the DRA's annuity and promissory note safe harbors are that the regular payments from such instruments are treated as income streams rather than resources, and the funds used to create them are not divestments. For a promissory note to qualify under the DRA statutory exception from divestment in 42 USC 1396p(1)(c)(I), the note must meet a three-pronged test by having: 1) an actuarially sound repayment term, 2) equal payments for the term of the loan with no deferral or balloon payments, and 3) no cancellation of the debt in the event of the lender's death. If a note satisfies the three-pronged test, it is considered DRA-compliant. The DRA promissory note safe harbor is repeated word-for-word in Michigan Bridges Eligibility Manual (BEM) 400, pp 40-41.

Unfortunately, annuities and promissory notes are complicated, and litigation ensued after the DRA was enacted in 2005. The two most transformational Medicaid decisions concerning the DRA are *Zahner v Secretary of Pa. Dept. of Human Services* (3rd Cir 2015) and *Hughes v McCarthy* (6th Cir 2013). Both decisions were argued by members of the National Academy of Elder Law Attorneys and both used federal supremacy to uphold annuities that complied with federal safe harbor rules against attempts by states to introduce their own annuity restrictions that deviated from the DRA's express language. Since the DRA's promissory note safe harbor is so similar to the DRA's annuity safe harbor, the holdings in *Zahner* and *Hughes* can be applied by analogy to counter state efforts to deviate from the express language of the DRA's promissory note safe harbor.

Reported decisions related to promissory notes appear to be isolated in the federal courts of Oklahoma and New Jersey. In Oklahoma, the decisions of *Gragert v Lake* (10th Cir 2013); *Frantz v Lake* (USDC 2014); *Peterson v Lake* (USDC 2014); and *Harper v State of Oklahoma* (USDC 2011) upheld the use of DRA-compliant promissory notes even though they were unsecured, created for Medicaid qualification purposes, and made between family members.

In *Peterson*, Ray Peterson, an unmarried man, age 88, and a nursing home resident, sold his home to his daughter, Susan, who gave back an unsecured DRA-compliant promissory note equal to the home's fair market value. The note also prohibited assignment or sale. A month later, Ray applied for Medicaid. The Oklahoma Medicaid agency denied Medicaid based on alternative theories of: 1) the home transfer was a divestment because the note lacked fair market value, 2) the note was "an available resource," i.e. countable, and (3) the note was a "trust-like device," i.e. an available resource. The federal court found there was no divestment because the note 1) satisfied the fair market value exception to divestment since the amount of the note was equal to the value of the home and 2) the note satisfied the three-pronged test of the DRA promissory note safe harbor. The court also held that the prohibition of assignment

provision in the note prevented the note from being marketable, and, therefore, was not an available resource. Finally, the court held that the note was not a "trust-like device" under the POMS' guidelines because it found that Susan's role was that of a note maker/borrower, not as a trustee, and that she was not holding the home for Ray's benefit. All four Oklahoma decisions disregarded that the use of the promissory note in question helped to achieve Medicaid eligibility, the note was unsecured, the borrower's creditworthiness was not investigated, and the parties involved were family members.

We see the alternative in New Jersey where federal courts have disapproved of unsecured promissory notes between family members under almost identical facts, even though the notes in the New Jersey cases were DRA-compliant. See *Wesner v Velez* (USDC 2010); *Sable v Velez* (3rd Cir 2010); and *Landy v Velez* (USDC 2013). The New Jersey cases take the position that satisfying the DRA's three-pronged test should either be disregarded or is just a minimal requirement to approve a note. They held that a promissory note must also satisfy the stricter "bona fide" note SSA POMS' guidelines used for SSI qualification, even though the DRA promissory note safe harbor did not mention the need to qualify under the stricter SSA POMS. These POMS' guidelines for "bona fide" notes require that 1) the loan and note be made in "good faith," 2) the loan be enforceable under state law, 3) the loan agreement must be in effect at the time the lender transfer funds, 4) the borrower acknowledges an obligation to repay, 5) the borrower provides a repayment plan with some form of security, and 6) the borrower's creditworthiness, resources, income, and expenses be considered before transferring funds. The POMS do not define when a loan/note arrangement is made in "good faith." To fill this void, the New Jersey federal judges engaged in judicial legislation by inventing their own anti-Medicaid planning definition, saying there is a lack of good faith when 1) there is a presence of a Medicaid qualification motive, 2) there is a family or friendship relationship between lender and borrower, or 3) the lender is not engaged in the business of lending money. All of these judicially-created tests for lack of good faith were seen in *Wesner*, *Sable*, and *Landy*, as the lender was an aging person who had entered a nursing home, the borrower was a friend or family member of the lender, and the motive in the transaction was to qualify the lender for Medicaid. It is important to note the Third Circuit's decision in *Sable* was "not precedential."

Where are DHHS and the MAHS administrative judges in this controversy? The only official written position is BEM 400, pp 40-41, which simply restates the DRA's promissory note safe harbor. However, in practice and without any written policy issuance, DHHS leadership in Lansing has unfortunately embraced the ill-considered positions of the New Jersey federal courts and rejected the decisions of Oklahoma. To make matters worse, at least two MAHS administrative law judges have followed DHHS's lead in administrative decisions.

The good news is that CMS's most recent informal advice on promissory notes takes the position that state Medicaid agencies should only use the DRA safe harbor in evaluating promissory notes. This position agrees with the Oklahoma federal decisions and disagrees with

New Jersey. Moreover, the reasoning of the federal decisions approving DRA-compliant annuities in *Zahner* and *Hughes* can be applied by analogy to reject the ill-considered reasoning of the New Jersey decisions. By contrast, the decisions of the 3rd Circuit in *Zahner* and the 6th Circuit in *Hughes* held under the Supremacy Clause, state laws, or state Medicaid agency policies cannot deviate from or add to the express language in federal Medicaid statutes, like the DRA.

Another reason for rejecting DHHS's use of SSA's restrictive-promissory note POMs and the New Jersey courts' formulation on good faith is that such an application violates basic due process notice for those applying for Medicaid who may wish to consider the use of a promissory note to reduce countable resources. Michigan courts have recognized DHHS must provide due process notice in the Medicaid process. See *In re Keyes Estate* (MI App 2015) and *In re Gorney Estate* (Mich App 2016). The only available written policy that alerts a Michigan Medicaid applicant about how to properly structure a promissory note is BEM 400, pp 40-41, which simply restates the DRA's three-pronged test. That's it. The BEM does not mention any of the additional SSA POMs strict bona fide note requirements nor does it mention the New Jersey courts' interpretations of "good faith." How then would an unsuspecting Medicaid applicant possibly know about such silent unwritten informal policies? Such a Medicaid applicant who structures a promissory note in accordance with official BEM policy would later discover that DHHS rejects the note for reasons not contained in the BEM.

If promissory notes are used to benefit a community spouse, two federal Medicaid statutes, in addition to the DRA, provide legal support for their use. For example, the Sixth Circuit in *Hughes v McCarthy* (6th Cir 2013) held that a DRA-compliant annuity which names a community spouse as payee can also be excepted from divestment treatment under the "sole-benefit of the individual's spouse" rule of OBRA '93. This holding equally applies to a DRA-compliant promissory note payable to a community spouse since such a note would similarly be for the "sole-benefit of the individual's spouse." The second supportive federal statute provides asset and income protections for the community spouse under the 1988 Medicare Catastrophic Coverage Act (MCCA). The intent of MCCA is "to protect community spouses from 'pauperization.'" One of MCCA's protections is that a community spouse's income, including income from a note, is not available to the institutionalized spouse but rather may be retained by the community spouse.

Here are practice tips to structure promissory notes to minimize DHHS rejecton:

1. **Making the Note Irrevocable and Nonassignable**. While the DRA's annuity safe harbor specifically requires that annuities be "irrevocable" and "nonassignable," the DRA's promissory note safe harbor does not. Even so, it is critical that these words be included in promissory notes, otherwise the notes lose their income status and will be treated as a countable resource. If a note were revocable, the note could be destroyed and its funds be returned to lender. If the note were assignable, it could be sold in the market.

If a note were commutable by the lender, the lender could immediately receive the present value of note payments. The following language should be included in notes:

> *Neither lender nor borrower may assign, convey, sell, transfer, bargain, grant this note or the payments herein, nor may lender commute or liquidate the payments herein, nor may borrower prepay the note payments.*

2. **Satisfying the DRA's Requirement that Note Cannot be Cancelled Upon Death of Lender.** It is recommended that the exact language in the DRA be included to satisfy the third prong of the DRA safe harbor: "*This note shall not be cancelled upon the death of the lender*." It is not recommended that the note designate a beneficiary who would receive any unpaid note payments in the event of the lender's death. Such a designation opens the door for a Medicaid agency to claim that the note is cancellable upon lender's death, especially where the note maker and the designated beneficiary are the same person or are related.
3. **Making Sure the Agreement to Lend and Execution of the Note are Contemporaneous.** What if the there is a significant time delay between the date funds are transferred from the lender to the borrower and the date the borrower signs the promissory note? This is what happened in a MAHS fair hearing decision issued on September 10, 2015, Reg. No. 15-013068, wherein an LTC Medicaid applicant made a series of gifts to her son, and four years later, as an afterthought, the son gave her back a promissory note in the amount of the gifts. One month later, the son discharged the note by filing bankruptcy. Therefore, the son paid nothing back from the note. The administrative law judge held that the note was a shell transaction between relatives that had no economic value, and thus failed to cure the earlier divestment because, at the time of the gift, the idea of a loan was not contemplated by the parties. This decision is consistent with the introductory language contained the DRA's promissory note safe harbor which states, "For purposes of the paragraph with respect to a transfer of assets, the term 'assets' includes funds used to purchase a promissory note, loan, or mortgage…." Congress's use of "used to purchase" infers that at the time the funds are transferred to the person who signs the note, the transferor and transferee intended that the transfer be a loan that would then be secured by a note signed by the transferee. To avoid a challenge, consider taking the following precautions: (1) use a written loan agreement between the lender and borrower before any funds are transferred and the note is signed, (2) the person or trust to whom funds will be transferred should employ separate legal counsel to negotiate the loan agreement and note, and (3) the borrower should sign the note on the same day that the funds are received from the lender.
4. **Make Sure the Borrower Actually Makes the Note Payments.** One of the easiest ways a Medicaid agency can show that a promissory note is not bona fide is when the borrower fails to make required monthly payments back to the lender, regardless of how carefully the note is drafted.

5. **Anticipate the Accusation that Use of the Note was Medicaid Motivated.** Most Medicaid eligibility workers and many administrative judges despise any legitimate Medicaid planning strategies employed by elder law attorneys, even strategies specifically protected by federal statutory safe harbors. In fact, DHHS's current rule has added a new unwritten requirement, not found in the BEM, that approvable promissory notes can have no Medicaid qualification motive. Such a policy has been squarely rejected in CMS's 2017 policy and the well-reasoned federal court decisions of *Zahner*, supra, and *Mertz Ex Rel. Mertz v Houtoun*. In an administrative hearing involving a promissory note, elder law attorneys should anticipate a client being asked by the Assistant Attorney General whether the client had a Medicaid qualification motive for using the note. Therefore, it is better to be proactive at the time of filing a Medicaid application when a note is in play by providing a full disclosure as to why the note merits approval.
6. **Avoid the Accusation that the Note is Trust-Like, and Therefore Countable.** Another argument that a Medicaid agency could use is to allege that the note is a "trust-like" device, and, therefore, the funds in the note are an available resource to the lender. This assumes that the loan/note is a sham and that the borrower is a fiduciary, holding the transferred funds for the lender's benefit. This argument is inconsistent with the new CMS policy and is weak in view of the strength of the DRA safe harbor if the note is DRA-compliant. However, the argument can get traction if the note's borrower is also the lender's child and agent under a financial POA, in which case the Medicaid agency can argue that the borrower is acting in his/her fiduciary role under the POA. Therefore, it is recommended that the person who receives the funds and signs the note not be the lender's agent under a POA. Consider using an irrevocable trust as the maker of the note.
7. **Avoid the Accusation that Lender's Creditworthiness was Not Considered.** A final challenge is when the lender makes no effort to consider the creditworthiness of borrower before transferring funds which is item D.5 of the SSA POMS. Even though the application of the SSA POMS is not required under the new CMS policy, it is prudent for the lender to consider the lender's creditworthiness requiring the borrower to disclose a financial statement, tax returns, and a favorable credit score. It is also prudent to have the note guaranteed by another person.

In conclusion, the recent CMS promissory note policy and annuity victories in *Zahner* and *Hughes* have breathed new life into the use of promissory notes. Using a promissory note for Medicaid qualification offers favorable income treatment and provides an exception from divestment, as long as it satisfies the three-pronged test of the DRA and other bona fide requirements, such as having a loan agreement in place at the time funds are transferred and making sure note payments are made. With a married couple, keep in mind that, a promissory note can also be justified under the sole benefit rule and MCCA. The advantage of using commercial annuities over promissory notes among family members is that such promissory

notes generate more hostility from Medicaid agencies. Therefore, when using a promissory note, practitioners should take extra precautions to satisfy applicable rules.

Calendar of Events

By Erma S. Yarbrough-Thomas, Neighborhood Legal Services Michigan Elder Law & Advocacy Center, Redford

ELDRS – www.michbar.org/elderlaw

- Sept. 16 - ELDRS Council Meeting, State Bar of Michigan, 306 Townsend, Lansing, 10 a.m.
- Oct. 4-6, ELDRS Fall Conference, DoubleTree by Hilton Hotel in Bay City, One Wenonah Park Place
- Oct. 5 – ELDRS Annual Meeting, DoubleTree by Hilton Hotel in Bay City, One Wenonah Park Place, 12:30 p.m.
- Nov. 4 - ELDRS Council Meeting, Location TBA, 10 a.m.
- Dec. 2 – ELDRS Council Meeting, Location TBA, 10 a.m.

NAELA – www.naela.org

- August 17-19 - 12th Annual Council of Advanced Practitioners Conference, Ritz Carlton Chicago
- Nov. 15-18, 2017 NAELA Summit, Summit Island Hotel, Newport Beach, CA
- Nov. 18 - 2017 NAELA Chapter Leader Roundtable, Newport Beach, CA

ICLE/SBM – www.icle.org

- Sept. 14-15 - Elder Law Institute, 3rd Annual, Plymouth (Live)
- Sept. 15 - Completing the Medicaid Application: A Hands-On Workshop, Plymouth (Live)
- Sept. 26 - Drafting an Estate Plan for an Estate Under $5 Million, Plymouth (Live)
- Oct. 12-14 & Oct. 27-28 - 40-Hour General Civil Mediation Training, Plymouth (Live)
- Oct. 19 - Courtroom Advocacy Workshop: Appearances and Motion Hearings, Plymouth (Live)
- Oct. 26 - Handling Contested Probate Proceedings, Plymouth (Live) Free to ICLE Partners
- Oct. 26 - Post-Death Tax Planning and Preparing Fiduciary, Estate, and Gift Tax Returns, Plymouth (Live), Free to ICLE Partners
- Nov. 2 - Ethics Update 2017, Plymouth (Live), Free to ICLE Partners
- Dec. 7 - Experts in Estate Planning: Estate and Distribution Planning for Retirement Benefits, Plymouth (Live)

Other Events

- Oct. 11 - State Bar of Michigan, “Who Should You Trust” seminars throughout Michigan