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Massachusetts Appeals Court Holds That the Power to Purchase an Annuity Does Not Render the Corpus of an Irrevocable Trust a Countable Resource

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Massachusetts Appeals Court Holds That the Power to Purchase an Annuity Does Not Render the Corpus of an Irrevocable Trust a Countable Resource

By Lisa M. Neeley, Esq.

About the Author

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In 2013, the Massachusetts Medicaid program, MassHealth, terminated the long-term care benefits of a nursing home resident, Everlenna Roche, because of the existence of an irrevocable trust — despite the fact that MassHealth had approved her benefits when Roche initially applied for them several years before. This benefit termination set into motion the case of *Heyn v. Director of the Office of Medicaid*, which was resolved in favor of Roche[1] by the Massachusetts Appeals Court on April 15, 2016.[2] The decision has been lauded by the state's elder law practitioners as clarifying that MassHealth must apply existing trust law when determining the countability of assets placed in an irrevocable trust in the Medicaid planning context.

I. Background

In 2003, Everlenna Roche established and funded the Everlenna R. Roche Irrevocable Trust.[3] The irrevocable trust provided Roche with the ability to receive distributions of income generated by the assets of the trust.[4] She was prohibited from receiving any distributions of trust principal.[5] Ms. Roche's daughter was the appointed trustee.

The trust was funded with Roche's primary residence, and a life estate was retained in the deed.[6] Roche also retained a special lifetime power of appointment in the trust, which granted her the ability to appoint trust assets to her children, free of trust.[7] The trust preserved grantor trust tax status by providing the trustee with the ability to exchange assets for those of equivalent value.[8] The trust also contained the typical administrative and investment powers enabling the trustee, for example, to purchase an annuity with trust assets and to allocate between income and principal.[9] Pursuant to the terms of the trust, any such allocation was to be made in accordance with reasonable accounting principles and state law.[10]

In 2011, eight years after the trust was created, Roche fell ill and was admitted to a long-term care facility. In conjunction with her admission, she applied for and was granted MassHealth long-term care benefits.[11] The existence of her irrevocable trust was disclosed to the agency when her application was submitted and initially approved.[12] However, in 2013, Roche received a notice from the agency stating that the trust was now being deemed a countable resource.[13] To enable Roche to retain her long-term care benefit eligibility, the trustee was ordered to remove the property from the trust and place it in Roche's individual name.[14] When the trustee refused to take such action, Roche's long-term care benefits were terminated. The termination was appealed, and a "fair hearing" was conducted before the state Office of Medicaid Board

1 Roche died during the pendency of the proceedings, and the personal representative of her estate, Eileen Heyn, was substituted as the plaintiff.

2 *Heyn v. Dir. Off. of Medicaid*, 89 Mass. App. 312 (2016).

3 *Id.* at 315.

4 *Id.*

5 *Id.*

6 *Id.* at 313.

7 *Id.* at 315.

8 *Id.* at 316.

9 *Id.*

10 *Id.* The state law alluded to in the trust is the Massachusetts Principal and Income Act, Mass. Gen. Laws ch. 203D (2006).

11 *Heyn,* 89 Mass. App. at 313.

12 *Id.*

13 *Id.*

14 *Id.*

of Hearings on June 20, 2013.[15] The hearing officer's decision, issued on October 8, 2013, upheld the agency's termination of benefits.[16] The termination was then appealed to the Massachusetts Superior Court, which also upheld the termination of Roche's benefits.[17]

II. Explosion in MassHealth Benefit Denials

The law governing the treatment of irrevocable trusts in the Medicaid planning context had remained the same since 1993. For irrevocable trusts created after 1993, the controlling federal statute provides that the corpus of an irrevocable trust is to be considered a countable resource if there are any circumstances under which any portion of its principal could be paid to the applicant for long-term care benefits.[18] The corresponding Massachusetts regulation similarly provides that irrevocable trust principal is considered countable only if it can be paid to the applicant for benefits.[19]

A. Doherty v. Director of the Office of Medicaid

The relatively static nature of the law regarding irrevocable trusts changed, however, when MassHealth began issuing frequent denials of long-term care benefits to applicants with irrevocable trusts.[20] The genesis of these attacks on Massachusetts trusts stems from *Doherty v. Director of the Office of Medicaid*, a 2009 appeals court case.[21] In *Doherty*, MassHealth denied long-term care benefits based on the existence of the applicant's irrevocable trust.[22] On its face, the Doherty trust appeared to prohibit distributions of principal to the MassHealth applicant and allow distributions of income only.[23] However, embedded within the trust was a provision allowing the trustee to terminate the trust agreement and distribute the entirety of the corpus of the trust to "the beneficiaries," which presumably included beneficiaries entitled to receive both income and principal distributions.[24] The *Doherty* court thus determined that the applicant could arguably receive distributions of trust principal pursuant to the termination clause. This provision ultimately rendered the corpus of the trust fully countable in the applicant's benefit eligibility determination.[25]

In dicta, the *Doherty* court discussed other provisions that possibly swayed its decision in favor of the agency. Such provisions included the ability of the trustee to allocate between income and principal, a clause allowing the applicant to use and occupy the residence transferred into the trust, and language that directed the trustee to conserve assets for the applicant's future needs to enable her to remain in the community for as long as possible.[26] In sprinkling a discussion of such trust language in the decision, the *Doherty* court unintentionally laid the groundwork for the agency's attempts in the years follow-

15 *Id.*

16 *Id.* Off. of Medicaid, Bd. of Hrgs., App. 1306280 (Oct. 8, 2013).

17 *Roche v. Thorn*, Mass. Super., WOCV2013-02261A (2013).

18 42 U.S.C. § 1396p(d)(3)(B)(i) (2010).

19 130 Code Mass. Regs. 520.023(C) (2016).

20 *See* William J. Brisk & Rebecca M. Flewelling, *Trusts Used in Medicaid Planning: The* Doherty *Challenge to Irrevocable Income Only Trusts and Its Aftermath*, 96(4) Mass. L. Rev. 95 (2015).

21 *Doherty v. Dir. Off. of Medicaid*, 74 Mass. App. 439 (2009).

22 *Id.*

23 *Id.* at 441.

24 *Id.*

25 *Id.*

26 *Id.* at 441–442.

ing the decision to expand the "any circumstances" test by counting virtually all irrevocable trusts as resources in long-term care benefit eligibility determinations.

B. Common Reasons for MassHealth's Benefit Denials

In light of the wave of benefit denials to applicants with irrevocable trusts following the *Doherty* decision, the reasons advanced by MassHealth to support these routine benefit denials have varied.[27] One of the more common arguments as to why an otherwise properly drafted irrevocable trust should be deemed countable in benefit eligibility determinations is the inclusion of certain investment and administrative powers.[28] For example, the agency has frequently claimed that the trustee's ability to sell a residence within a trust and then invest the proceeds in an annuity renders the assets of the trust fully countable.[29] The agency has also argued that despite trust language prohibiting the distribution of principal to the applicant or otherwise limiting the trustee's investment discretion to act in accordance with reasonable accounting practices, the trustee could classify the entirety of an annuity payment as income and subsequently pay all of the proceeds, consisting of both the income and principal portion, to the MassHealth applicant.[30] Another common reason for denial is the inclusion of a power of appointment clause, which the agency claims renders the assets of a trust fully countable because it grants the applicant the ability to distribute trust assets to children, who in turn could distribute such assets back to the applicant.[31] The ability of the trustee to substitute assets with those of equivalent value has also been perceived by the agency as granting the applicant with unfettered access to principal.[32]

III. Board of Hearings and Superior Court Proceedings

In the Board of Hearings decision, the hearing officer advanced several reasons for deeming the assets of the Roche trust countable resources.[33] Primarily, the hearing officer determined that the trustee's ability to sell the trust assets and subsequently purchase an annuity rendered the assets of the trust countable because there was "nothing" precluding the trustee from distributing the entirety of the annuity proceeds to Roche.[34] He made this conclusion irrespective of any consideration for accounting issues, as acknowledged in the decision.[35] The hearing officer also determined that Roche's ability to appoint trust assets to her children via the power of appointment rendered the assets of the trust countable because she could theoretically appoint the assets to her children, who in turn could return the assets to her.[36] The trustee's ability to substitute assets with those of equivalent value was also problematic, because the hearing officer reasoned that the assets could be distributed to Roche upon demand, without any need for her to replace them with assets of equal value, as specified by the trust.[37]

The hearing officer theorized that the "any circumstances" test under federal law

27 Brisk & Flewelling, *supra* n. 20.

28 *Id.* at 99–102. (The article contains a comprehensive survey of reasons cited for the denial of benefits to applicants with irrevocable trusts.)

29 *Id.* at 101–102.

30 *Id.*

31 *Id.* at 100–101.

32 *Id.* at 112.

33 Off. of Medicaid, Bd. of Hrgs., App. 1306280.

34 *Id.* at 12.

35 *Id.*

36 *Id.* at 11.

37 *Id.* at 11–12.

provided the agency with the authority to concoct any scenario under which principal could be paid to Roche, even if such a distribution would be in direct conflict with the express terms of the trust prohibiting such a distribution.[38]

In affirming the agency's decision, the Massachusetts Superior Court motion judge primarily relied upon the argument that trust assets could be used to purchase an annuity, which could be distributed to the income beneficiary, noting that the language of the trust allowed a set of circumstances under which the plaintiff could receive principal via the purchase and distribution of an annuity.[39]

IV. Appeals Court Decision

Heyn was the first case resulting from MassHealth's wave of benefit denials based on the existence of an irrevocable trust to be heard by the Massachusetts Appeals Court. The Massachusetts Chapter of NAELA had a keen interest in the case and submitted an amicus brief in support, with the goal of turning the tide against the wave of frequent unlawful denials experienced at the MassHealth application stage.[40] Writing the opinion for a unanimous court, Justice Mark Green summarily rejected all of MassHealth's arguments as to why certain provisions within the trust rendered principal payable to Roche despite clear trust language to the contrary.[41]

Specifically, the court reiterated that the standard to be used to determine whether assets held in an irrevocable trust are countable for purposes of determining an applicant's eligibility for long-term care benefits is the "any circumstances" test.[42] This test, codified at 42 U.S.C. §1396p(d)(3)(B)(i), provides that the principal of an irrevocable trust is countable in determining an applicant's eligibility if any portion of such principal could be paid to or for the benefit of the applicant.[43] As the court noted, "Such circumstances need not have occurred, or even be imminent" in order for the principal of the trust to be considered a countable resource.[44] "It is enough that the amount could be made available to Roche under any circumstances."[45]

The court first addressed the agency's argument that the trustee could sell the property, invest the proceeds in an annuity, and treat the resulting annuity payments wholly as income eligible for distribution, while presumably ignoring the fact that an annuity comprises both income and principal and no principal could be distributed to Roche under the terms of the trust.[46] This argument was rejected, with the court ruling that the hearing officer's conclusion regarding this provision "misapprehends the nature of annuity payments."[47] Annuity payments, the court reasoned, comprise distinct and separately identifiable parts.[48] One part is income; another part is principal. The income portion would be eligible for distribution to Roche as income beneficiary, whereas the principal portion would have to be retained in the trust and could not be paid out to Roche under any circumstances.[49]

The agency also claimed that the trustee's ability to allocate between principal

38 *Id.*

39 *Roche,* WOCV2013-02261A.

40 The submittal of the amicus brief was acknowledged in the appeals court decision. *See Heyn,* 89 Mass. App. at 313 n. 2.

41 *Id.*

42 *Id.* at 314–315.

43 *Id.*

44 *Id.* at 315.

45 *Id.*

46 *Id.* at 316.

47 *Id.* at 317.

48 *Id.*

49 *Id.*

and income pursuant to article eight of the trust would somehow enable the trustee to categorize the entirety of the principal of the fictitious annuity as income, thus justifying the distribution of the entirety of the annuity proceeds to Roche as income beneficiary. The court also rejected this argument, noting that its analysis was "unaffected by the authority of the trustee … and noted by the motion judge, to determine the allocation as between principal and income of any proceeds of trust assets … ."[50] The trustee's ability to make such an allocation was specifically limited by reasonable accounting principles, practice, and state law.[51] Thus, the trustee was limited by both the terms of the trust and state law in making such an allocation. The state law alluded to in the trust is the Massachusetts Principal and Income Act, which creates a statutory presumption that all amounts received by the trustee are principal, not income.[52]

The court rejected the hearing officer's conclusion that the power of appointment somehow rendered the assets of the trust countable, in full, to Roche.[53] Specifically, the hearing officer opined that under the special power of appointment, Roche could appoint assets to her children, who in turn could give them to her. However, the court stated, "The hearing officer cited no case in which either rationale was applied to support a conclusion that assets held in an irrevocable trust should be treated as countable assets for purposes of the trust grantor's Medicaid eligibility, and we are aware of none."[54] The court was then careful to note that because the agency could not consider assets held by family members — who might elect to voluntarily contribute to pay for the care of their elderly relatives — as countable resources in determining an applicant's benefit eligibility, the agency similarly could not consider assets subject to a special power of appointment countable for the sole reason that such assets could somehow be returned to the applicant.[55]

Also dispensed with was the agency's claim that the trustee's ability to substitute assets for those of equivalent value rendered the assets of the trust countable.[56] The court found that this argument was "[e]ven less persuasive" than the hearing officer's other rationale for upholding the agency's denial.[57] Such an exchange "would not effect any distribution or diminution of trust principal, any more than a sale of trust assets to unrelated third parties, followed by a reinvestment of sale proceeds by the trust."[58]

Heyn affirmed the ability of individuals in Massachusetts to use irrevocable trusts as long-term care planning tools. Despite the slew of agency benefit denials to applicants with irrevocable trusts in the preceding years, such trusts were specifically recognized as valid, with Justice Green writing:

> The legislative history and case law concerning the treatment of self-settled trusts reflect awareness of the possibility that comparatively affluent individuals might avail themselves of such trusts as an estate planning tool, in order to qualify for benefits. … The resulting law reflects a compromise, with provisions for so-called "look back" peri-

50 *Id.* at 317–318.

51 *Id.*

52 *See* Mass. Gen. Laws ch. 203D, § 18(a).

53 *Heyn*, 89 Mass. App. at 318.

54 *Id.*

55 *Id.*

56 *Id.* at 319.

57 *Id.*

58 *Id.*

ods for transfers of assets preceding an application for benefits … and strict requirements governing the extent to which assets must be made unavailable to the settlor in order to avoid being treated as "countable assets" for purposes of Medicaid eligibility. Nonetheless, it is settled that, properly structured, such trusts may be used to place assets beyond the settlor's reach and without adverse effect on the settlor's Medicaid eligibility.[59]

V. Conclusion

MassHealth declined to petition the Massachusetts Supreme Judicial Court for further appellate review of the appeals court decision. With the decision now final, Massachusetts elder law attorneys and their clients remain hopeful that the decision will go a long way toward reigning in MassHealth's benefit denials to applicants with otherwise properly drafted irrevocable trusts and clarifying current law regarding counting such trusts in determining an applicant's benefit eligibility.

However, challenges to MassHealth applicants with irrevocable trusts remain, with the agency most recently challenging an applicant's continuing ability to reside in a home placed in trust, such as through the retention of a life estate or use and occupancy clause. The agency argues that if the applicant remains in the home following its transfer into trust, the entirety of the corpus of the trust is rendered a countable resource in the applicant's benefit eligibility determination. The agency made a similar argument in the *Heyn* case but lost on this point at the Board of Hearings level and dropped this argument in the superior court proceeding. The *Heyn* court did note in its decision via footnote that the agency had conceded in its brief on appeal that a life estate was not countable in determining an applicant's benefit eligibility.[60] The "use and occupancy" cases are presently making their way through the Massachusetts court system, with the first such case, *Nadeau v. Thorn,* to be decided by the appeals court within the coming year.[61] However, practitioners are hopeful that with continued zealous advocacy, the tide will continue to turn in favor of the continuing use of irrevocable trusts in the Medicaid planning context.

59 *Id.* at 314.

60 *Id.* at 313 n. 3.

61 *See Nadeau v. Thorn*, Mass. App. Docket 2016-P-0608 (2016).