In ***Zahner v. Secretary, Pa. Dept. Of Human Services***, the Third Circuit upheld the use of very short-term Medicaid qualified annuities as a permissible Medicaid eligibility strategy. In both cases, the annuities were used as part of a strategy to cover the cost of care during a period of ineligibility while getting "otherwise eligible" to start the penalty on gifts to adult children. This use of short term annuities is an alternative to "gift and return," which is not available in Pennsylvania.

This is the third straight victory of the elder and disability law community over Pennsylvania Medicaid, all litigated by National Academy of Elder Law Attorneys (NAELA) members and all with NAELA's support as *amicus*. The earlier cases dealt with DHS attempts to stop the use of spousal annuities before the Deficit Reduction Act,[1] or to hamstring the use of pooled special needs trusts.[2]

Zahner involved short annuities – 12 to 18 months for people with life expectancies of eight to 10 years. Both applicants were denied eligibility on resource grounds, which would not start the penalty period running. The applicants then sued DHS in federal court, seeking injunctive and declaratory relief. The Department claimed that these annuities were not "actuarially sound" because they were too short compared to the annuitant's life expectancy, relying

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1

James v. Richman, 547 F.3e 214 (3rd Cir. 2008); *see also Mertz ex rel. Mertz v. Houstoun*, 155 F.Supp. 2d 415 (E.D. Pa. 2001), where the district court denied injunctive relief but did find that where the plaintiff purchased a five-year annuity for fair market value, the transaction could be penalized under the transfer rules even if the purpose was to qualify a spouse for Medicaid.

2

Lewis v. Alexander, 685 F.3d 325 (3rd Cir., 2012), ***cert. denied,*** 184 L.Ed.2d 724 (2013).

on material from Transmittal 64[3] that referred to the annuities being "commensurate" with anticipated longevity. It also argued that these annuities were "sham transactions" with no economic value other than to qualify the applicants for Medicaid without first paying over all of their excess resources to a nursing home. The federal district court agreed with the state, referring to a "smell test" having to do with the purpose of the annuities.

The Third Circuit reversed. In so doing, it observed that a Medicaid planning motive does not prohibit the use of short-term annuities provided the statutory safe harbor requirements for their use are met, as occurred in this case. The term "actuarially sound," which does not have meaning in the context of an individual case, was only intended by the federal agency to impose an upper limit on the term of the annuity to preclude someone *else* from benefitting from the annuity given the likelihood that the annuity would outlast the beneficiary. The Court cited the NAELA amicus brief for this observation and the conclusion that Congress adopted that meaning in putting it into the statute.

To the extent that allowing the use of such annuities was bad social policy, the Court said, that was not its job. It did, however, point out in a footnote that the lower court failed to recognize countervailing policy considerations that weigh in favor of short-term annuities. Specifically, it cited the NAELA amicus brief in observing that "shorter annuities make it possible for people with fewer assets to purchase annuities. Being able to purchase an annuity for multiple years requires a large upfront cost that aging, low-income individuals may not have access to."

The dissent agreed with DHS that the annuities were sham transactions because of their lack of economic value other than to qualify for Medicaid.

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[3] Transmittal 64 contained the implementation of the OBRA 1993 Medicaid provisions by the predecessor agency of the Centers for Medicare and Medicaid services. OBRA 1993 introduced the use of first party individual and pooled special needs trusts and, for the most part, lightened the operation of the transfer rules.