The Retirement Security Project

Protecting Low-Income Families' Savings:

How Retirement Accounts Are Treated in Means-Tested Programs And Steps to Remove Barriers to Retirement Saving

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Common sense reforms, real world results

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Preface

By Peter R. Orszag[1]

The past 25 years have seen a dramatic shift in our nation's pension system away from defined benefit plans and toward defined contribution accounts such as 401(k)s and IRAs. Our public policies, however, have largely not been updated to reflect this shift. The Retirement Security Project is dedicated to promoting common sense solutions to improve the retirement income prospects of millions of American workers. This Retirement Security Project Policy Brief, written by a team of authors from the Center on Budget and Policy Priorities, addresses a critical impediment to retirement savings among low- and moderate-income workers: the outdated asset tests in means-tested benefit programs.

The asset tests represent one of the most glaring examples of how our laws and regulations have failed to keep pace with the evolution from a pension system based on defined benefit plans to one in which defined contribution accounts play a much larger role. At the time the asset-test rules were developed, defined benefit plans were the norm and were generally disregarded in applying these tests. In contrast, defined contribution accounts like 401(k)s and IRAs generally were *not* exempted in part because they were viewed as being supplemental retirement plans that could be drawn upon if necessary prior to retirement. People who encountered hard times during their working years were expected to liquidate their 401(k) or IRA accounts and use the proceeds before qualifying for means-tested assistance.

Since then, the pension system has shifted away from defined benefit plans, and defined contribution accounts have moved from supplemental plans to the dominant form of saving for retirement on top of Social Security. Yet the asset rules have largely not been updated, so many programs still exempt defined benefit plans while counting 401(k)-type

accounts and IRAs. As a result, many low- and moderate-income workers or families who are contributing to retirement savings accounts are disqualified from stop-gap assistance programs such as the Food Stamp Program, cash welfare, Medicaid, or Supplemental Security Income. To quality for these programs during periods of hardship, they must first withdraw and spend the proceeds in their retirement accounts even if that depletes their primary form of retirement saving outside Social Security.

The asset tests thus act as a steep implicit tax on retirement savings, since those who make the sacrifice to save for retirement through a defined contribution plan or IRA are penalized. Not only is the result highly inequitable, but this policy likely also discourages saving for retirement among a portion of the population that also is provided little incentive to save under our tax laws. Furthermore, the treatment of retirement accounts under the asset tests for these programs is often arbitrary and confusing. For example, this Policy Brief shows that low-income workers who roll a 401(k) over into an IRA when they switch jobs, as many financial planners suggest they should, can disqualify themselves from the Food Stamp Program.

A growing body of evidence suggests that making it easy for low- and moderate-income families to save, and presenting them with a clear and effective financial incentive to do so, succeeds in generating significantly higher contributions to retirement accounts. For example, participation rates among new employees — even low-earning ones — rise substantially when 401(k) plans are reformed so that they are essentially opt-out instead of opt-in. In other words, modifying the retirement plan so that a new worker's default option is participation in the plan significantly increases the likelihood that this new worker will contribute to the 401(k) plan. New research from the Retirement Security Project, based on a path-breaking randomized experiment, underscores that the combination of a clear and understandable match for saving, easily accessible savings vehicles, the opportunity to use part of an income tax refund to save, and professional assistance could generate a significant increase in retirement saving participation and contributions, even among low- and moderate-income households.

Yet if the above policy changes were made to encourage saving among low- and moderate-earners, the outdated asset tests in means-tested benefit programs would penalize the households that responded by saving. This Policy Brief addresses this problem by documenting how the current rules work, explaining why they are harmful, and pointing the way to common sense reforms that will bring our retirement savings laws up-to-date. These issues are complicated but crucially important. We are grateful to the Center on Budget and Policy Priorities for its outstanding work in wading through the current complexities of the asset tests and coming up with sensible options for reform.

Protecting Low-Income Families' Retirement Savings:

How Retirement Accounts Are Treated in Means-Tested Programs And Steps to Remove Barriers to Retirement Saving

By Zoë Neuberger, Robert Greenstein and Eileen P. Sweeney

Introduction

As currently designed, asset tests not only penalize low-income savers but also may actually discourage retirement saving in the first place.

Low-income families tend to save very little and accumulate few or no assets. They tend to have particularly low levels of retirement savings. Even when combined with Social Security benefits, their savings are often insufficient to maintain their preretirement standard of living. Policymakers have expressed a goal of increasing retirement savings among those with low or moderate incomes, which would reduce poverty among elderly households. Policymakers and program administrators can further this important goal by modifying asset rules in means-tested benefit programs to remove penalties imposed on retirement saving by low- and moderate-income families.

Many low-income families rely on means-tested programs at times during their working years—during temporary spells of unemployment or at times when earnings are insufficient to make ends meet. The major means-tested benefit programs, including food stamps, cash welfare assistance, Medicaid, and Supplemental Security Income (SSI), either require or allow states to apply asset tests when determining eligibility. The asset tests may force households that rely on these benefits—or might rely on them in the future—to deplete modest retirement savings before qualifying for benefits, even when doing so would involve a financial penalty. As currently designed, asset tests not only penalize low-income savers but also may actually discourage retirement saving in the first place.

Asset tests in means-tested programs, as currently applied, thus constitute a barrier to the development of retirement savings among the low-income population. Modifying or even eliminating these asset tests, or disregarding savings in retirement accounts when applying the tests, would allow low-income families to build retirement savings without having to forgo means-tested benefits at times when their incomes are low during their working years.

In addition to imposing what amounts to a steep implicit tax on saving, the asset tests treat retirement saving in a confusing and seemingly arbitrary manner. For example, policymakers often encourage workers to roll the balances in a 401(k) account into an IRA when they switch jobs, rather than cashing out the 401(k) balance. Yet in some cases, rolling the 401(k) account into an IRA could disqualify a worker from means-tested benefits.

Fortunately, substantial progress can be made to mitigate the penalty on saving and simplify the rules in a number of means-tested programs. The law governing employer-based retirement accounts like 401(k) plans and individual accounts like IRAs could be revised to exempt all such accounts from being considered when a household applies for federal means-tested benefits. Even in the absence of such a change in law, states have flexibility to disregard retirement accounts in specific programs. In Medicaid, the State Children's Health Insurance Program (SCHIP), and programs funded under the Temporary Assistance for Needy Families (TANF) block grant, states have complete discretion over the treatment of assets,

States now have the flexibility to craft a more coherent set of asset rules.

Key Opportunities for States to Remove Barriers to Retirement Savings by Modifying Asset Rules in Means-Tested Benefit Programs

- Align rules regarding retirement accounts in Medicaid (for nonelderly households) and TANF cash assistance to the Food Stamp Program rules, by not counting 401(k) accounts and similar employer-based plans as assets under the Medicaid and TANF programs.
- Similarly, disregard IRAs in Medicaid and TANF cash assistance, as well as in the Food Stamp Program, to the extent that forthcoming food stamp rules allow states to do so, so that families with children and people with disabilities who have an IRA, including those who do not have access to an employer-based retirement plan and those who must roll over funds from an employer-based plan into an IRA when they are laid off or change employers, will not have to liquidate retirement savings to obtain means-tested benefits during a period of need.
- Eliminate the Medicaid asset test for families with children.

including retirement accounts. In the Food Stamp Program, states have the ability to liberalize asset rules within federal parameters and, for the time being, to disregard all retirement accounts if they are disregarded in the state's TANF cash assistance or family Medicaid program. In contrast, the federal SSI program requires the application of an asset test under which most retirement accounts are counted as assets.

The result of the different policies that currently exist in these programs is that some retirement accounts are counted in certain programs but not in others, with the exact treatment across programs dependent on the state.[2] Some households that have saved for retirement can retain those savings when they need to turn to means-tested benefits, while similar families that have used a different retirement saving vehicle or live in a different state may have to deplete their retirement savings or forgo means-tested benefits during a time of need. And, some households may be able to benefit from some programs but not others as a result of the different rules across programs. Fortunately, as a result of recent changes in federal policies, states now have the flexibility to craft a more coherent set of asset rules that treat different kinds of retirement savings more fairly and exempt more of these savings from asset tests, while simplifying program administration.

This report explains the asset rules for the Food Stamp Program, TANF, Medicaid, SCHIP, and SSI, with emphasis on how various kinds of retirement accounts are treated. The report highlights both changes at the federal level that would facilitate retirement savings and opportunities for states to remove barriers to retirement saving under current law and to conform asset rules across programs.

Types of Retirement Savings Accounts

In the United States, there are three main sources of retirement income: income from Social Security benefits, income from employer-based retirement plans, and individual savings. Social Security is intended to provide the foundation of retirement security, but is not intended to be sufficient by itself to support people in retirement. Thus, employer-based retirement plans and individual savings are important sources of retirement income. Such retirement savings are the focus of this report. This section provides a description of the main types of retirement savings vehicles.[3]

Employer-Based Plans

Employer-based retirement savings plans fall into two broad categories: defined benefit plans and defined contribution plans.[4] In any given year, about half of the workforce is covered by an employer-based plan of one of these types, although coverage varies greatly depending on the type of employer (as well as on the age, race, and education level of the employee).[5]

Defined *benefit* plans provide a specific benefit based on an employee's earnings record; the benefit provided to the retiree is not affected by the rate of return on the funds invested in the plan. Thus, the employer, rather than the employee, bears the investment risk. Over the last three decades, coverage by defined benefit plans has shrunk dramatically—from 39 percent of all private-sector employees in 1975 to 21 percent in 1997—while participation in defined contribution plans has grown.[6] Contributions to defined benefit plans are generally held by the employer in a single account—rather than by the employees—and generally are not counted as an asset when a household applies for means-tested benefits.

Defined *contribution* plans do not promise a certain benefit level during retirement. The amount of payments upon retirement depends instead on the level of contributions made to an individual's account and the rate of return on the funds invested. With these plans, employees bear the investment risk. The most common defined contribution plans allow employees to make tax-deferred contributions. (That is, the employee does not pay income tax on the earnings contributed to the retirement savings plan until the funds are withdrawn.) The amount that employees can contribute to 401(k)s and similar plans each year is capped, but at such a high level that the cap does not affect the vast majority of workers.[7] Often both employers and employees make contributions to these plans. For the purposes of means-tested programs, no distinction is made based on the source of the contribution. Contributions to defined contribution plans are generally held in an account in the employee's name, and their impact on eligibility for means-tested benefits depends on the rules of the particular benefit program. (The rules of various programs are described in the following sections of this report.) The most common defined contribution plans follow a similar design but have different names depending on the nature of the employer:

- **401(k) plans** are offered by private companies;
- **403(b) plans** are offered by not-for-profit organizations and public education agencies;

- **457 plans** are offered by state and local governments; and

- **Savings Incentive Match Plans for Employees (SIMPLEs)** are offered by small private-sector employers and have some features similar to individual saving plans, which are described in the next section.

Individual Savings

The most common *individual* (as distinguished from employer-based) retirement savings vehicle is the individual retirement account (IRA), which is a retirement savings account that receives special tax treatment. Anyone who has earned income (or whose spouse has earned income) may have an IRA. Only households that have enough income to pay income taxes today or will have sufficient income to owe income taxes in the future can benefit from the special tax treatment. In 1997, only 2 percent of workers with adjusted gross income (for tax purposes) below $20,000 participated in an IRA.[8]

IRA contributions are limited to $4,000 in 2005. The limit will increase to $5,000 by 2008 and will be indexed to inflation after that.[9] There are two main kinds of IRAs: traditional IRAs and Roth IRAs. Traditional IRAs offer front-loaded tax benefits—that is, contributions are tax deductible, and the interest earned on the account is not taxed when the interest accrues—but withdrawals from IRAs *are* taxed. Roth IRAs, by contrast, offer back-loaded tax benefits—contributions are *not* deductible, but withdrawals are tax free.[10] The general principle that applies to both types of IRAs is that earnings placed in an IRA are taxed either at the time they are earned or at the time they are withdrawn from the IRA, but not at both times, and interest accumulates within the account tax free. Whether a traditional IRA or a Roth IRA offers greater benefits to a particular individual depends on the individual's earnings pattern, as well as on features of the tax code during the individual's lifetime. Roth IRAs are typically more advantageous for low-income people who do not currently earn enough to owe income tax but may earn more and owe income tax in the future. Under traditional IRAs, withdrawals by someone who is less than 59 1/2 years old are subject to a penalty except in certain circumstances, and withdrawals must begin by age 70 1/2. The rules differ somewhat under Roth IRAs.

Two other kinds of individual retirement savings vehicles are Simplified Employer Pension Plans and Keogh plans. SEPs are IRA-like accounts into which employers make direct deposits. A Keogh plan is a tax-deferred retirement savings plan for people who are self-employed. While it may resemble an IRA in some respects, the Keogh is essentially an employer-sponsored plan (treating the self-employed person as employer and employee). Accordingly, the contribution limit can be the much higher limit that applies to employer-sponsored plans, rather than the IRA limit. Contributions to a Keogh plan are fully deductible for income tax purposes at the time they are made, and interest accumulates tax free; taxes are paid when withdrawals are made. As with other employer-sponsored plans and IRAs, withdrawals by someone who is less than 59 1/2 years old are subject to a penalty except in certain circumstances, and withdrawals generally must begin by age 70 1/2.

Preretirement Withdrawals

One consideration sometimes used in determining whether retirement accounts should be counted when determining eligibility for means-tested programs is how accessible such accounts are and the penalties for early withdrawals. For the general population, 401(k)s are less accessible than IRAs, but for low-income households the accessibility of the two types of accounts is not very different in practice. For low-income households, the relatively modest differences in the conditions under which 401(k) plans and IRAs may be accessed would not seem to warrant different treatment when determining eligibility for means-tested benefits.

As a general rule, households may withdraw funds from their IRAs at any time, subject to potential penalties and taxes, while 401(k)s have more restrictions on withdrawals. There are several circumstances, however, under which households can make early withdrawals from their 401(k) accounts. Many individuals with a 401(k) who have income low enough to participate in a means-tested program can qualify to make these early withdrawals. As a result, for low-income households, the accessibility of 401(k)s is not very different from the accessibility of IRAs.

Although most 401(k) participants may not withdraw funds from their accounts, certain categories of individuals may access their 401(k) accounts without penalties, including, but not limited to the following:[11]

- people with disabilities;
- individuals over age 59½; and
- individuals over age 55 who have left or lost their jobs.

Certain other individuals are permitted to make withdrawals from their 401(k) plans but are subject to a penalty of 10 percent of the taxable amount they withdraw. Individuals who are no longer employed by the organization that set up the 401(k) plan may withdraw funds from their account (subject to the 10 percent penalty if they are under age 55 when their employment terminates). Under this provision, many low-income households have access to the funds in their 401(k) plans. Other individuals who face financial hardship also may access their accounts, subject to the penalty in many cases.[12]

Why Is Retirement Saving by Low-Income Families Important?

Low saving rates by poor families have been consistently documented.[13] Low-income families tend to have inadequate retirement savings and are much less likely to participate in employer-based or individual tax-preferred retirement savings plans than higher-income households. In 1997, among households with adjusted gross income below $20,000, only 22 percent participated in an employer-provided retirement saving plan or held an individual retirement account, whereas 51 percent of *all* employees saved for retirement using such vehicles.[14] Among certain groups, participation in employer-based plans is even lower. For example, in 1999, only 6 percent of employees earning less than $10,000, 14 percent of part-time employees, and 18 percent of employees with less than a high school diploma were covered by an employer-based retirement plan.[15] Across all groups, about three-quarters of private-sector employees who were not covered worked for an employer who did not offer retirement plans.[16]

Moreover, when low-income households do participate in such retirement saving plans, they tend to contribute a smaller share of their income than higher-income households. For example, in 1992, the average contribution rate to 401(k) plans for employees with household income below $25,000 was 3.7 percent of pay, whereas employees with household income exceeding $75,000 contributed an average of 7.9 percent of pay.[17]

In recent years, policymakers have expressed growing interest in raising retirement saving by low-income households. There are four main reasons to increase retirement saving rates by low-income households: to reduce elderly poverty and improve the standard of living of low-income seniors, to increase national saving rates, to reduce the numbers of individuals who need to rely upon means-tested programs after they retire, and to reduce the large inequities in government subsidies for retirement saving.

Increasing saving by low-income households would increase the number of seniors who can maintain an adequate standard of living. For many very low-income households, Social Security benefits do not provide even a poverty-level income. Allowing low-income families to accumulate retirement savings

There are four main reasons to increase retirement saving rates by low-income households: to reduce elderly poverty and improve the standard of living of low-income seniors, to increase national saving rates, to reduce the numbers of individuals who need to rely upon means-tested programs after they retire, and to reduce the large inequities in government subsidies for retirement saving.

to supplement their Social Security benefits during retirement would reduce poverty among elderly households. Even families with moderate incomes typically do not save enough for retirement. In 2001, the median balance in employer-based retirement savings plans and IRAs among families on the verge of retirement was only $10,400, which would be insufficient to maintain the family's standard of living for more than a few years in retirement.[18]

In addition to the benefits to seniors, broader economic benefits would result from increasing retirement saving rates among low-income households. One of the nation's economic imperatives is to raise the national saving rate to prepare for the retirement of the baby-boom generation. To increase savings, government policies must not simply cause individuals to shift assets from one form to another, but must generate additional contributions. Since low- and moderate-income families are less likely to have assets to shift, policies aimed at encouraging saving by such families are more likely to result in additional saving.

Increased retirement savings by low-income households may also reduce the numbers of individuals who need to rely upon means-tested programs after they retire. In Medicaid, for example, it costs much more to insure the average elderly person than the average non-elderly one, and allowing people to accumulate retirement savings during working years (even while receiving Medicaid) could reduce or eliminate some people's need for Medicaid in retirement.

Increasing retirement savings is an important-enough goal that significant federal funds (about $150 billion annually in tax benefits) are devoted to subsidizing such saving, primarily through the special tax treatment of employer-based retirement plans and IRAs.[19] These tax subsidies disproportionately benefit more-affluent individuals. In 2004, about 70 percent of the tax benefits from new contributions to 401(k) plans accrued to the highest-income 20 percent of tax filing units, and more than half of the tax benefits went to the top 10 percent of tax filers.[20] Modifying the rules governing how retirement accounts are treated in means-tested programs to allow and encourage low-income households to build some retirement savings would modestly reduce the large inequities in the distribution of federal support for retirement saving.

How Should Retirement Assets Be Treated in Means-Tested Programs?

Policymakers have expressed interest in increasing retirement saving by low-income households. By excluding employer-based retirement savings accounts such as 401(k)s and individual retirement savings accounts like IRAs from the asset tests in means-tested benefit programs, policymakers could remove a potentially steep burden imposed on saving by low-income families. Policies that consider only whether a retirement account is in some way accessible to an applicant—and that count defined contribution pension plans while excluding defined benefit pension plans, as some means-tested programs do—undermine the broader goal of encouraging low- and moderate-income families to save adequately for retirement. Such policies also are inequitable, since a household is effectively discriminated against if its employer has one type of pension plan (a defined contribution plan) rather than another type of plan (a defined benefit plan). Finally, the current rules are often difficult to administer and understand. The rules could be substantially simplified while also reducing the extent to which they penalize retirement saving.

The empirical research examining the impact of asset tests on saving, while not conclusive, suggests that raising or eliminating asset tests could increase saving by low-income households.[21] Even if liberalizing the asset rules alone is not sufficient to change saving behavior on a broad scale, it is an important precursor to other policies and programs designed to increase saving by low-income families.

Low-income families are unlikely to save more if doing so jeopardizes access to means-tested benefits that might be crucial to them during a period of hardship.

Congress could enact legislation providing that funds a person has set aside in a retirement account will not be counted in determining eligibility for federally-funded means-tested benefits. There is precedent for including such a cross-program provision in the tax code; the part of the tax code related to the Earned Income Tax Credit includes a provision regarding the treatment of the EITC by other means-tested programs.[22] Congress included a similar provision in the 2001 tax-cut legislation, with regard to treatment of the child tax credit by means-tested programs. Provisions that exclude certain federally-funded Individual Development Accounts from being counted as assets in federal means-tested programs provide another precedent.[23]

Inclusion of such a provision in federal law could have salutary effects and would emphasize the importance Congress places on encouraging individual saving by all Americans, including those with low incomes. Such an approach also would simplify program administration and eliminate the confusion that can exist when programs have different rules.

In the absence of such a blanket disregard for retirement accounts, different options are available to states in different programs, as explained in subsequent sections of this report. There are three main ways to modify means-tested programs to reduce barriers to retirement saving:

- Eliminate the asset test and consider only income when determining eligibility;
- Raise the asset limit; or
- Disregard retirement savings accounts or some portion of them.

In situations in which a state is unable or unwilling to adopt one of those policies, it might at least disregard certain types of retirement accounts.

Trade-Offs in Designing Asset Rules

When designing asset policies for means-tested benefit programs, policymakers face trade-offs. Raising or eliminating asset limits allows low-income families that have assets to keep them while relying on public benefits to weather a period of economic hardship. Liberalizing asset tests also should encourage new saving by some low-income families. At the same time, eliminating asset limits or substantially increasing the asset limits arguably might somewhat lessen public support for the programs, although there is no sign of a lessening of public support as a result of the changes that a number of states have made in recent years to eliminate or liberalize asset tests in Medicaid and food stamps.

There also are trade-offs in terms of administrative complexity. From a policy standpoint, it might make sense to treat particular kinds of assets differently—depending on factors such as how accessible the asset is, what it may be used for, and the penalties for use. The more nuanced the policy, however, the more difficult it is to administer. With a complicated policy, more questions have to be asked in the application process, caseworkers have to understand more about different types of saving vehicles, and households applying for benefits may have to provide more documentation even if there are relatively few instances in which the assets ultimately affect eligibility.

As the sections of this report that follow illustrate, there is a good deal of complexity in the asset rules of various means-tested programs. Simplifying the treatment of different kinds of assets within programs and across programs is an important goal, although administrative simplicity does not outweigh all other considerations.

There also is a cost associated with raising or eliminating asset tests; doing so makes more people eligible for benefits. The cost to the federal government should be considered in the context of other federal policies related to retirement

saving. As described in the previous section, federal expenditures to promote retirement savings are heavily skewed toward higher-income households. In addition, if households can receive means-tested benefits when they experience temporary periods of hardship during their working years and can do so *without* having to liquidate and consume their retirement funds, then fewer households should need to rely on means-tested benefits in retirement.

The cost to states of raising or eliminating asset tests depends on the funding structure of the means-tested program. Increases in food stamp costs have very limited implications for states because benefits are federally funded. (States cover half of administrative costs.) In Medicaid, in which states pay an average of 43 percent of benefit costs, increases in program costs that result from changes in asset rules have more significant budget implications. If more people receive TANF cash assistance, there are no costs to the federal government because TANF is funded by a block grant, with fixed amounts of federal funding provided. To fund an increase in cash assistance costs, states would need either to reduce TANF funding in another area or increase state funding for TANF-related programs. (The other major programs discussed in this report—the Food Stamp Program, Medicaid, and SSI—all operate as entitlements, which means that making new people eligible for benefits does not mean others will be turned away.)

The Treatment of Retirement Savings

The treatment of retirement accounts under the asset tests in means-tested programs poses a unique set of policy dilemmas. Retirement saving vehicles are less accessible than various other forms of saving, such as a checking account. When they are accessible, there often are penalties for withdrawing funds before retirement. In addition, different kinds of retirement accounts often are treated differently under the programs' asset rules, creating inequities depending on the kind of retirement saving plan that an applicant's employer provides.

Defined Benefit and Defined Contribution Employer-Based Plans

Certain retirement plans—known as defined benefit plans—generally are not counted as assets in eligibility determinations for means-tested programs. As explained in the previous section, these plans offer a specified benefit to the employee upon retirement regardless of the investment return on the funds. The employer holds the funds, and there is no individual account for a specific employee.

In many means-tested programs, the general premise underlying asset rules, which were developed in the early 1970s, is that funds accessible to the applicant should be counted because they could be used for daily expenses, but inaccessible funds should not be counted. At the time these rules were developed, defined benefit retirement plans were the norm, so employer-based retirement plans were generally disregarded when families needed to turn to means-tested benefits during their working years. Since the 1970s, however, employer-based retirement plans have shifted away from the defined benefit model, and defined contribution plans have become the norm. Because under defined contribution plans, there is an account in the employee's name and the employee can access that account under certain circumstances (although often with a penalty), means-tested programs often count these plans as an asset.

This discrepancy in the treatment of defined benefit plans and defined contribution plans disadvantages the many employees who do not have access to defined benefit plans. The discrepancy exists because the retirement savings landscape has shifted over the past thirty years while the treatment of retirement savings in the asset tests of means-tested programs has not followed suit. Treating defined benefit and defined contribution

plans similarly would be much more equitable and would remove a significant barrier to increasing retirement saving by low-income working households.

In fact, drawing a clear distinction between defined benefit and defined contribution plans for such purposes makes less and less sense over time. Hybrid plan designs have developed, and each type of plan (defined benefit and defined contribution) has been evolving to resemble the other more closely. In particular, traditional defined benefit plans have been converted in large numbers to hybrid "cash balance" and "pension equity" formats that blend elements of the defined benefit and defined contribution models. These plans look and function much like defined contribution plans from the standpoint of the employee while giving employers the flexibility associated with defined benefit–type funding rules. One important way in which defined benefit plans have come to resemble defined contribution plans is that they have increasingly replaced other forms of payout with lump-sum distributions—a single cash payment available when the individual leaves the employer that sponsors the plan (or, in the case of many traditional defined benefit plans, when the individual leaves the plan sponsor *and* reaches an early retirement age such as 55).

Employer-Based Plans and Individual Saving Plans

In addition, some programs, including the Food Stamp Program, generally disregard employer-based retirement saving plans—including defined contribution plans—but count individual saving accounts like IRAs. This, too, is inequitable, since low- and moderate-income households that use IRAs are likely to be households that canno use an employer-based retirement plan because their employers do not offer one.

Moreover, this distinction may reflect a misperception that IRAs are more accessible than employer-based plans for low-income households. As explained in the previous section, for low-income households, access to each kind of saving plan is not very different.

Finally, when an individual with a 401(k) plan or other defined contribution plan ceases to work for the employer who sponsors the plan (most likely because the employee has changed jobs or been laid off), the individual sometimes must withdraw his or her retirement funds.[24] To retain the funds in a tax-favored retirement saving vehicle, the employee must "roll over" the funds into an IRA (unless the employee is permitted to transfer the funds to his or her new employer's retirement plan). A large share of IRA accounts are, in fact, simply 401(k) accounts that have been rolled over. It is inequitable for a means-tested program to exclude funds in a 401(k) account while an individual works for a particular employer, but to change course and count the same funds simply because the low-wage worker has changed jobs or been laid off and had to roll over the funds into an IRA.

Savings after Retirement

Another consideration is whether retirement accounts should be treated differently once an individual has reached retirement age. A small number of individuals purchase a lifetime annuity upon retirement, in which case there is no longer an account in the retiree's name. Means-tested programs generally do not count lifetime annuities as assets.[25] (The monthly annuity payments that are made are generally considered income.) Other retirees do not purchase a lifetime annuity and instead withdraw funds periodically from their accounts on either a regular schedule (such as monthly over ten years) or from time to time on an ad hoc basis. In those cases, the funds remaining in such retirement accounts are treated in accordance with the programs' asset rules.

From the standpoint of avoiding disqualification from a means-tested benefit program because of the program's asset rules, buying a lifetime annuity thus may be advantageous. A

A retiree who earned low wages throughout his or her career and had an average life expectancy would need approximately $30,000 to maintain 70 percent of his or her preretirement income level over the duration of his or her retirement.

lifetime annuity also ensures that retirement savings do not run out before an individual dies.

Yet for many low-income retirees, buying a lifetime annuity is *not* financially beneficial. A lifetime annuity is generally not a wise financial investment for someone who does not expect to reach the average life expectancy for a retiree, and low-income people tend to have shorter-than-average life expectancy.

In particular, if an average earner purchased an annuity, the value of the retirement savings used to make the purchase would be reduced by about 15 percent; many annuity carriers have traditionally used 15 to 20 percent of the individual's savings to cover the risk the company incurs that the individual will live longer than average (and hence require the company to pay out more over time) and to cover the company's administrative costs and profits.[26] For low-income workers, who tend to have shorter life expectancies than the average worker, the reduction would be even larger. Low-income households should not be forced to choose between buying an annuity that would not be wise for them financially and being eligible for means-tested benefits that they need.

How Much Retirement Savings Are Needed?

The amount of savings needed to support a former earner during retirement is larger than the amount that might be needed earlier in the life cycle when the individual is still working and drawing a wage or salary. One very limited measure of self-sufficiency *while a household is still of working age* is whether a household has sufficient net worth to cover poverty-level consumption needs for three months.[27] In 1997, a one-person household would have needed a net worth of $2,500 to cover poverty-level consumption needs for three months, and larger households would have needed more.[28]

As a result, households that are subject to a $2,000 asset limit, a common limit in food stamps and other programs, are prevented from accumulating a cushion to sustain a minimal standard of living for even a brief period. Raising the asset limit by a few thousand dollars would allow most low-income families to accumulate this level of savings. (Note: The food stamp asset limit was set at $1,750 when the Food Stamp Act was enacted in 1977 and raised to $2,000 in 1985. It has not been adjusted since. If the asset limit had kept pace with inflation so it had the same value today as in 1977, it would now be over $5,400.)

In contrast, $5,000 or even $10,000 in savings is clearly insufficient to finance a family's needs over an extended period, such as over a worker's retirement. For retirees whose earnings were consistently low throughout their careers, Social Security payments replace about 56 percent of prior earnings if benefits are claimed at age 65.[29] If such a retiree sought to use savings to make up the difference between Social Security and 70 percent of his or her former earnings level, which would put the retiree just over the poverty line, the retiree would need about $2,000 in additional income from savings *for each year of retirement* to make up the difference.[30] A retiree who earned low wages throughout his or her career and had an average life expectancy would need approximately $30,000 to maintain 70 percent of his or her preretirement income level over the duration of his or her retirement. This is why there is such a strong case for the asset tests of means-tested programs to disregard savings in retirement accounts or, at a minimum, to disregard retirement savings up to a substantial level.

The Food Stamp Program

Program Overview

The federal Food Stamp Program began as a small pilot in 1961 and gradually grew into the nation's largest food assistance program. Over twenty-five million individuals received food stamps in November 2004.

Food stamp benefits are designed to fill the gap between the money a family has available to purchase food and the estimated cost of a modest diet. They generally are available to families with gross incomes below 130 percent of the poverty line. Families also must meet an asset test (discussed in more detail below) and certain other eligibility requirements.

Most food stamp eligibility rules are set at the federal level, with day-to-day administration of the program carried out by states. As explained below, however, in some areas—including the treatment of assets—states have flexibility to set policy within broad federal parameters.

The Food Stamp Program differs from other major benefit programs in several key ways. Food stamps serve a wide range of needy people and are not restricted to specific populations such as the elderly, families with children, or people with disabilities.[31] This makes the program a particularly important part of the safety net for low-income households. Food stamp benefits are 100 percent federally financed. The federal government shares the costs of administering the program equally with the states.

Treatment of Assets in Food Stamps

Food stamp eligibility depends in part on a household's assets.[32] Once a household is eligible for food stamps, its assets do not affect the amount of monthly benefits it receives. (A household's benefit level is based on its income. The greater a household's countable income, the more money it is assumed to have available to purchase food and the smaller the monthly food stamp benefit it receives.)

The Food Stamp Program's asset test has two related parts: an overall limit on the total amount of countable assets a household may have and a vehicle asset limit that is applied in conjunction with the overall limit.[33] The portion of the value of a household's vehicle that exceeds the program's vehicle limit counts toward the program's overall asset limit. If a household's countable assets exceed the asset limit, the household does not qualify for benefits.

Overall Asset Limit

In general, households are not eligible for food stamps if they have more than $2,000 in countable assets, or more than $3,000 if at least one household member is disabled or age 60 or older.[34] Countable assets include cash on hand or in the bank, stocks, bonds, and the "excess value" of vehicles, as explained below.[35]

Items that do *not* count as assets include a household's home, personal items, the cash value of any life insurance policy, property that the household uses to earn income (such as farm equipment), and items the household cannot sell or use to purchase food (such as the security deposit on an apartment).[36]

The assets of households in which *all* members receive TANF-funded cash assistance and/or benefits from the Supplemental Security Income program (the basic federal cash assistance program for poor individuals and couples who are aged or have disabilities) are disregarded in food stamp eligibility determinations. For these households and individuals, the Food Stamp Program effectively follows the asset rules of these other programs.[37]

In addition, under federal regulations issued in November 2000, states may disregard the assets of households that receive TANF-funded benefits, such as job counseling or child-care subsidies for working families.[38] If a particular benefit or service program receives *more* than half of its funding through TANF, the state must disregard the assets of individuals who receive the benefit or service. If a program receives *less* than half its funding through TANF, the state has the option to disregard the assets of individuals who receive the benefit or service. If the state determines that the benefit or service inures to the entire household (regardless of the portion of the benefit or service that is funded through TANF), the state may disregard the assets of the entire household.

Finally, under a new option created by the 2002 farm bill, a state may choose not to count certain types of assets toward the food stamp asset limit if the state does not count these assets toward the asset limit it uses in its TANF cash assistance program or toward the asset limit it uses for families covered under Medicaid.[39] This new option is very significant; it opens new avenues for states to exclude more retirement accounts from the food stamp asset test. How retirement accounts may be treated under this provision is discussed in more detail below.

The Vehicle Asset Limit

Although there are specific federal rules regarding how to consider vehicles in food stamp eligibility determinations, states now have considerable flexibility to establish their own food stamp vehicle policies that are much less restrictive than the federal rules.[40] Only two states continue to use the federal rule.

Under the *federal* food stamp rules, the "excess value" of most vehicles—defined as the amount by which a vehicle's fair-market value exceeds $4,650—is counted as part of a household's countable assets.[41] For example, if the value of a vehicle exceeds the $4,650 limit by $500 (because the vehicle is worth $5,150), the household is presumed to have $500 in countable assets from the vehicle. That $500 is added to the value of the household's other resources, such as bank accounts, to see if the household's total countable assets fall below the overall asset limit of $2,000 (or $3,000 for a household with an elderly or disabled member). For households with more than one vehicle, each vehicle is evaluated separately against the $4,650 threshold.

States may, however, establish their own food stamp vehicle policies that are less restrictive than these federal rules. In fact, states may eliminate the vehicle test altogether. At present, 39 states exclude entirely at least one vehicle per household in determining food stamp eligibility, and approximately 25 of these states exclude the value of *all* household vehicles.[42] Liberalizing or eliminating the federal food stamp vehicle rule has the effect of liberalizing the overall food stamp asset test for families with vehicles because the excess value of those vehicles no longer counts toward the $2,000 limit.

Treatment of Retirement Accounts in Food Stamps

Some types of retirement savings accounts are counted toward the food stamp asset limit while other types of retirement accounts are excluded.[43] Most employer-sponsored retirement plans are excluded. The types of accounts that are excluded include, but are not limited to, the following:[44]

- Defined benefit plans;
- 401(k) plans;
- 403(b) plans;
- 457 plans;
- the Federal Employee Thrift Savings plan;
- Section 501(c)(18) plans, which are retirement plans for union members; and
- Keogh plans that involve a contractual obligation with someone who is not a household member.

The following types of retirement savings are *counted* as an asset for food stamp purposes, regardless of whether there is a penalty for early withdrawal:

- IRAs;
- Keogh plans that involve no contractual obligation with someone who is not a household member; and
- Simplified Employer Pension Plans, which are IRA-like accounts into which employers make direct deposits.

If the cash value of an excluded type of plan is "rolled over" into an IRA, *it loses its exclusion* and becomes a countable asset following the rollover. This rule is very significant. An employee often must take his or her retirement benefits out of the employer's defined benefit plan or

defined contribution plan when he or she stops working for the employer. For such funds to remain in a tax-favored retirement saving account, the employee must roll the funds over into an IRA (unless the employee is able to roll the funds into a new employer's retirement plan). A large share of IRAs are 401(k) or other defined contribution accounts that have been rolled over.

This food stamp rule means that changing jobs or being laid off can cause a low-wage working family with a modest retirement account to lose the exclusion for the account and hence to be terminated from the Food Stamp Program unless the family liquidates its retirement account and spends the proceeds.

The New Food Stamp Option

An important new option for disregarding certain retirement plans has recently been made available to states. Under provisions of the farm bill enacted in 2002, a state may choose not to count certain types of assets toward the food stamp asset limit if the state does not count these assets toward its asset limit for TANF cash assistance recipients or toward its asset limit for families covered under Medicaid.[45]

One important caveat is that the Food Stamp Program must count certain assets even if they are disregarded in TANF cash assistance or family-based Medicaid. The 2002 law specifies that the assets that *cannot* be disregarded for food stamp purposes include cash and "amounts in any account in a financial institution that are readily available to the household."[46] The law does not define "readily available." The U.S. Department of Agriculture, which administers the Food Stamp Program, will determine the meaning of this phrase through program regulations.

This requirement raises the question as to whether funds in an IRA are "readily available" to the account-holder.

Proposed regulations that the Department of Agriculture issued in April 2004 would allow states to disregard IRAs if the terms of these accounts impose a penalty, other than forfeiture of interest, for early withdrawal. Some comments submitted to USDA in response to the proposed regulations argued that the final regulations should go further and afford states flexibility to disregard IRAs generally.

Until final regulations are issued, USDA has advised states that they may exercise discretion regarding the treatment of IRAs.[47] For the time being, so long as a state excludes funds in IRAs from its TANF *or* its family Medicaid asset test, it may exclude them from the food stamp asset test as well.[48] As of August 2003, only Ohio had acted to disregard IRAs as an asset based on this option, although there may be other states that have done so since then.[49] Most states decided to wait for the final regulations before making policy decisions in this area. If the final regulations are the same as the proposed regulations, then states should be able to exclude IRAs that impose a penalty for pre-retirement withdrawals, so long as they do so in their TANF cash assistance or family Medicaid program.

The 2002 farm bill also included a similar provision that allows a state to conform what counts as *income* in the Food Stamp program to the definition of income in its TANF cash assistance or family Medicaid program. Generally, interest that accrues on *nonexempt* retirement accounts is counted as income when determining eligibility for food stamp benefits. (Interest accruing on exempt accounts is *not* counted as income.) Under the 2002 provision, however, states may cease counting the interest on *non*exempt accounts as income under the Food Stamp Program. This provision of the law gives state Food Stamp Programs the flexibility *not to count* as income most items that a state excludes from income under either its TANF cash

assistance program or its Medicaid program for families. This should permit states to exclude interest on nonexempt retirement plans from being counted as part of a household's income under the Food Stamp Program, so long as a state excludes such interest income in its TANF or family Medicaid program.[50]

Opportunities for Policy Improvements Under Current Law

Excluding retirement accounts generally from being counted for purposes of the food stamp asset test would simplify program administration and facilitate retirement saving by low-income individuals. Once USDA publishes final regulations, states will be able to disregard retirement accounts in the Food Stamp Program to the extent the new federal rules allow; they will be able to do so by disregarding such accounts in their TANF cash assistance or family Medicaid programs and aligning their food stamp rules accordingly.[51] If final food stamp regulations preclude some or all types of IRAs from being disregarded under this conformity option, states will continue (under federal food stamp rules) to disregard the vast bulk of *employer*-based retirement plans—including 401(k) plans and similar defined contribution plans, and defined benefit plans—when determining eligibility for food stamps. If final food stamp regulations preclude some or all types of IRAs from being disregarded under this conformity option, under current program rules states still will disregard the vast bulk of *employer*-based retirement plans—including 401(k) plans and similar defined contribution plans—when determining eligibility for food stamps.

As described in subsequent sections of this report, states have the option of excluding 401(k) plans and other such defined contribution plans in their TANF and Medicaid programs as well. (Defined benefit plans already are universally disregarded.) By taking advantage of this option in TANF and Medicaid, a state could conform the treatment of defined contribution retirement plans across the Food Stamp, TANF, and Medicaid programs, which itself would represent a significant policy advance in many states.

In addition, states can disregard interest income on IRAs or 401(k) plans when counting a household's *income*, as long as the state excludes such interest income in its TANF or family Medicaid programs. It is difficult and administratively burdensome for caseworkers to track the small amounts of interest income earned on these accounts. As a practical matter, such income may already be overlooked by many caseworkers. By disregarding such interest as a matter of policy across food stamps, TANF, and Medicaid, states can simplify program administration.

Temporary Assistance for Needy Families

Program Overview

The Temporary Assistance for Needy Families (TANF) block grant, created by the 1996 welfare law, provides states with $17 billion a year in federal TANF funding. States also contribute funds; each state must meet a maintenance-of-effort (MOE) requirement each year by spending at least 75 percent of the amount it spent on certain welfare programs in federal fiscal year 1994.

States use the federal TANF funds and the state maintenance-of-effort funds for a wide array of programs, such as cash assistance benefits, welfare-to-work programs, child-care subsidies, child welfare services, transportation assistance, and pregnancy prevention programs.[52] States have broad flexibility to establish eligibility and other rules in these programs. While all states use a portion of their TANF funds on cash assistance benefits, those benefits now account for only a little more than one-third of total TANF spending.[53]

Treatment of Assets in TANF

States have very broad discretion to determine eligibility criteria, including income and asset limits, for TANF-funded benefits and services.[54] Moreover, a state can set different eligibility tests for different TANF-funded programs or services. For example, a state could limit TANF cash assistance to very poor families but provide TANF-funded child care to working families with somewhat higher incomes.

Many TANF-funded programs do not impose an asset test, including many child-care subsidy programs, child welfare services, after-school programs, and pregnancy prevention programs. However, all states except two (Ohio and Virginia) do have assets tests in their TANF *cash assistance* programs.[55]

This tendency may reflect the federal rule in place before the 1996 welfare law that limited eligibility for cash welfare benefits to families with less than $1,000 in assets. Most states have since increased the asset limit above the $1,000 level. Most states now set limits between $2,000 and $3,000. In TANF cash assistance programs, eligibility is determined based on the circumstances of the "assistance unit" rather than the entire household; thus, the assets of an extended family member who is part of the household but not part of the assistance unit are not counted toward the asset limit.

As in the Food Stamp Program, when calculating the value of a family's assets for purposes of determining eligibility for TANF cash assistance, some states count a portion of a family's car as an asset. Twenty-nine states entirely disregard the value of at least one vehicle when determining a family's countable assets. The remaining states generally disregard the value of a vehicle up to a certain limit, ranging from $1,500 to $12,000.[56]

Treatment of Retirement Accounts in TANF

States have complete flexibility regarding what to count as assets. Thus, a state can disregard any or all kinds of retirement accounts. We are not aware of any compilation of state rules regarding how retirement accounts are treated under the asset tests in state TANF programs. For a given state, such information can be obtained from a state's TANF plan or its regulations, guidance, or policy manuals.[57]

In addition, states have flexibility regarding what counts as *income*. A state can exclude the interest earned on any or all retirement accounts. Most states count interest income in general, but it is unclear whether interest income is counted if the underlying retirement account is excluded.[58]

Opportunities for Policy Improvements Under Current Law

Since many states do not use asset tests in TANF-funded programs other than cash assistance programs, the opportunities described below apply primarily to TANF cash assistance programs.

A state can establish policies that exclude *all* retirement accounts, and their interest income, from eligibility and benefit determinations for TANF cash assistance. Alternatively, a state can disregard specific types of retirement accounts. A uniform rule for all types of retirement accounts ensures that families are not treated differently based on the particular retirement savings vehicle they hold—and also reduces the complexity of program rules that caseworkers and families must follow.

If a state chooses to disregard only some types of retirement accounts, then it should, at a minimum, disregard the types of retirement accounts—401(k) and similar plans—that are disregarded in the Food Stamp Program. Most cash

A state can establish policies that exclude *all* retirement accounts, and their interest income, from eligibility and benefit determinations for TANF cash assistance.

assistance recipients also receive food stamps, so aligning asset rules would allow the application process for the two programs to be integrated more easily. Moreover, disregarding 401(k) and similar plans would eliminate the inequity between employees who have defined benefit plans, which generally are disregarded, and those who have access to defined *contribution* plans like 401(k)s. (Unfortunately, such a policy would not help families that had rolled over a 401(k) plan into an IRA to retain tax-favored treatment of the savings after being laid off or changing jobs.)

Alternatively, states can effectively exclude most retirement accounts from consideration when determining TANF cash assistance eligibility or benefit levels by raising overall asset limits to a level where most retirement accounts would not affect TANF eligibility. This option would allow all low-income savers to accumulate a limited amount of savings regardless of the savings vehicle they choose. Because raising the overall asset limit would make additional low-income families eligible for cash assistance, this policy change would increase cash assistance costs. Likewise, disregarding retirement savings would increase cash assistance costs modestly.

Medicaid and the State Children's Health Insurance Program

Program Overview

Established in 1965, Medicaid is a public health insurance program for low-income individuals and families. In 2001, Medicaid covered about forty-seven million people, including twenty-three million children, twelve million adults in families with children, eight million persons with disabilities, and four million elderly persons.[59]

On average, the federal government pays 57 percent of state Medicaid costs; states pay the remaining 43 percent. States must comply with certain federal requirements, but there are important policy areas over which states have considerable flexibility. For example, to qualify for federal matching funds, states must offer insurance coverage to several specific populations, including the following: certain low-income children and pregnant women; families that would have qualified for cash welfare assistance under the Aid for Families with Dependent Children program that existed in the state prior to the 1996 welfare law; and (in most states) elderly and disabled individuals who are eligible for the Supplemental Security Income program.[60] This coverage must, at a minimum, include coverage for certain health-care services, such as physician care and hospital care. States also may cover additional services, such as prescription drugs and personal-care services. In addition, states may provide Medicaid coverage to certain "optional" populations, including near-poor parents and children, elderly and disabled people who live below the poverty line but are not poor enough to qualify for SSI, and low-income people who have high medical costs but whose income modestly exceed the income limits for other Medicaid eligibility categories.[61]

In determining Medicaid eligibility, states consider both whether a person fits into an eligible category and the person's income and assets. The federal government has given states considerable flexibility in setting income and asset limits, as well as what the states count as income and assets. As a result, state policies in these areas vary widely.

As part of the Balanced Budget Act of 1997, Congress also established the State Children's Health Insurance Program (SCHIP), under which the federal government is providing $40 billion over ten years to states to expand health insurance coverage to low-income uninsured children. States may use SCHIP

States That Have Eliminated the Medicaid Asset Test for Families with Children

Alabama	Louisiana	Oklahoma
Arizona	Massachusetts	Pennsylvania
Connecticut	Mississippi	Rhode Island
Delaware	Missouri	South Carolina
District of Columbia	New Jersey	Virginia
Illinois	New Mexico	Wisconsin
Kansas	North Dakota	Wyoming
	Ohio	

See *Beneath the Surface: Barriers Threaten to Slow Progress on Expanding Health Coverage of Children and Families*, Donna Cohen Ross and Laura Cox, Center on Budget and Policy Priorities for the Kaiser Commission on Medicaid and the Uninsured, October 2004, table 8, available at http://www.kff.org/medicaid/7191.cfm.

funds to expand children's coverage under Medicaid or to create separate state children's health insurance programs.

If a state uses SCHIP funds for a Medicaid expansion, the state's Medicaid eligibility rules apply.[62] If a state creates a separate children's health insurance program, the state has complete flexibility over income and asset rules. States with such programs generally cover children in families with incomes up to about 200 percent of the poverty line ($31,340 for a family of three in 2004), but some states cover children in families with somewhat higher incomes. Currently, more than four million children are covered through SCHIP.

Treatment of Assets in Medicaid and SCHIP

States have significant discretion in establishing asset rules for determining Medicaid and SCHIP eligibility. They have the flexibility under federal law to waive or liberalize asset tests for most Medicaid populations and to determine what types of assets count when applying an asset test.[63] Since asset policies vary across states—and within a state across different categories of beneficiaries—the treatment of assets depends on the state and the Medicaid category under which an individual or family would be eligible, as well as the state's rules regarding what counts as an asset. It is important to note that state asset tests in Medicaid, as well as the asset tests in the few states that use them in separate SCHIP programs, apply to families rather than to entire households. The assets of an extended family member, such as a grandparent, are not counted toward the asset limit when a family unit consisting of parents and children applies for coverage.

Formerly, states used Medicaid asset tests equivalent to the tests that they used in their closely related cash assistance programs. Medicaid asset rules for families with children followed those used in state AFDC programs, while the federal SSI asset rules governed in determining Medicaid eligibility for people who were elderly or had a disability.[64] In recent years, however—and especially since enactment of the 1996 welfare law—many states have liberalized their Medicaid asset tests. (A table of each state's Medicaid asset limits for children and families appears in appendix A.)[65]

Most states have elected to *eliminate* the Medicaid asset test for children.[66] Some forty-five states and the District of Columbia have now done so.[67] (The elimination of the asset test for children means that parents' assets do not affect

their children's eligibility for Medicaid.) In addition, twenty-one states and the District of Columbia have eliminated the Medicaid asset test for *families* with children, rather than eliminating the test only for children and not for their parents as well.[68]

States have generally retained asset tests for applicants who are elderly, blind, or disabled. A table of each state's asset limit for elderly, blind, or disabled individuals and couples in selected coverage categories appears in appendix B.[69]

- The asset limit for individuals in the optional "medically needy" category for people who are elderly or disabled—the category for low-income elderly or disabled people who have high medical costs but too much income to qualify for Medicaid in another category—ranges from a low of $1,600 in Connecticut to a high of $10,000 in Iowa. The asset limit for such individuals in most states is $2,000 to $3,000.[70]

- The asset limit for elderly, blind, or disabled people in other coverage categories is often aligned with the federal SSI asset limit of $2,000 for an individual and $3,000 for a couple, although states have the option to set higher limits and some states do so for some coverage categories.

- In the Medicaid coverage categories for what are known as Qualified Medicare Beneficiaries and Specified Low-income Medicare Beneficiaries, the asset limit is $4,000 for an individual and $6,000 for a couple.[71] These categories consist of people who are elderly or disabled with incomes below 120 percent of the poverty line who are not eligible for SSI, but for whom the *Medicaid* program pays part or all of the beneficiary's share of *Medicare* costs.

The implications of these asset limits for an applicant's eligibility depend in large part on how states use their flexibility to define what counts as an asset. For example, most of the states that have retained a Medicaid asset test for families with children use their flexibility to exclude from countable assets the entire value of one family automobile.[72] Some states still count the value of a vehicle as an asset above certain fixed dollar amounts, usually no less than $1,500. The treatment of retirement accounts is discussed below.

As already noted, if a state has used SCHIP funds to expand its Medicaid program for children, the asset rules for children under the state's Medicaid program apply to the newly covered children as well. Under federally approved waivers, several states have used SCHIP funds to extend Medicaid coverage to the parents of SCHIP-eligible children (and in some cases, to other adults). In these states, the Medicaid asset rules that the state applies to other families with children apply to these parents as well.[73]

States that use SCHIP funds to finance separate children's health insurance programs have total flexibility over whether to apply an asset test in these programs and, if so, how to design that test.[74] Among states with separate SCHIP programs, all but three (Idaho, Oregon, and Texas) do *not* apply an asset test for children. As is the case with Medicaid, this means that parents' assets do not affect their children's eligibility for SCHIP.

Treatment of Retirement Accounts in Medicaid and SCHIP

States have complete flexibility with regard to which types of assets — including which types of retirement accounts — are considered when applying asset tests in Medicaid or SCHIP.

Most of the thirty states that still use an asset test in their Medicaid programs for families with children count retirement savings in 401(k) plans, as well as IRAs, as assets, even though a state can opt to exclude such accounts. (The table in

appendix A shows how each state that uses an asset test for families treats retirement accounts.)

Since states generally apply an asset test to applicants who are elderly, blind, or disabled, the treatment of retirement accounts is especially important for these populations. No compilation of state Medicaid policies for the elderly and disabled is available that covers the treatment of retirement accounts. Some states follow the rules of the SSI program. Under SSI, defined benefit retirement plans are generally disregarded as assets while an individual either is employed by the firm that sponsors the retirement plan or is receiving regular payments from the plan; defined contribution plans and IRAs generally are counted. (The treatment of retirement plans under SSI is examined in the next chapter of this report.) An explanation of a state's Medicaid asset policies for elderly, blind, or disabled beneficiaries can be found in its state Medicaid plan.[75]

One related issue is how states treat interest earned on retirement accounts. Such income is difficult to track. Moreover, unlike in food stamps, TANF cash assistance, or SSI—in which interest income can affect the *level* of benefits—interest income rarely makes a difference with regard to whether an individual or family qualifies for Medicaid coverage. States could simplify program administration by disregarding such interest as income, using their flexibility with regard to what counts as income. It is unclear whether many states have adopted such a policy.

Opportunities for Policy Improvements Under Current Law

States have considerable flexibility over whether and how to count assets for most Medicaid and SCHIP populations. States thus have substantial opportunities to encourage retirement savings and simplify program administration by modifying their Medicaid (and SCHIP) asset rules.

States can waive their Medicaid asset tests entirely for both children and their parents. Few states still administer a Medicaid asset test for children. The majority of states retain an asset limit for parents, although twenty-two states have now disposed of asset tests for such families. States that have dropped the asset test for families generally have reported that doing so helped them to streamline the eligibility determination process and reduce administrative costs while easing the enrollment process for families.[76]

States that continue to impose a Medicaid asset test for families with children can disregard savings held in all types of retirement accounts. In some states, this would require state legislative approval. Once approval is obtained, states need only submit a state plan amendment to the Centers for Medicare and Medicaid Services (CMS) to implement this disregard.

At a minimum, states that impose a Medicaid asset test could conform their Medicaid policy with the policy in the Food Stamp Program and disregard retirement savings in 401(k)s and similar plans. Making such a change would simplify administration of the Medicaid program and facilitate integration of Medicaid and food stamp eligibility determinations. In addition, disregarding 401(k) and similar plans would eliminate the inequity between employees who have defined benefit plans, which are generally disregarded, and those who have access only to defined contribution plans like 401(k) plans. Unfortunately, such a change would not help employees who had to roll over their 401(k) savings into an IRA upon changing jobs or being laid off.

Through waivers, states can use SCHIP funds to extend coverage to populations besides children, such as low-income parents. If a state that undertakes such an expansion has no asset test for children, applying the same rule to parents would make the program simpler

States can waive their Medicaid asset tests entirely for both children and their parents.

Eighteen of the thirty-two states that offer Medicaid Buy-In programs for people with disabilities have chosen to exclude retirement accounts from counting as assets.

Asset Test for Low-Income Subsidies for New Medicare Drug Benefit Will Count Many Retirement Accounts

Beginning in January 2006, Medicare will provide coverage for outpatient prescription drugs. The coverage will be partial; most Medicare beneficiaries will have to pay a substantial amount in monthly premiums, annual deductibles, and co-payments. The law provides, however, for subsidies to defray part of these costs for: 1) those low-income Medicare beneficiaries who are also enrolled in Medicaid (including beneficiaries who do not receive full Medicaid coverage, but for whom Medicaid pays their Medicare premiums); 2) low-income beneficiaries who receive SSI but not Medicaid; and 3) Medicare or SSI beneficiaries who are not enrolled in Medicaid but whose incomes and assets are below certain levels.

There are several tiers of these low-income subsidies. People who are covered by Medicaid or SSI, or whose income is below 135 percent of the poverty line and whose assets are less than $6,000 for an individual or $9,000 for a couple, will qualify for the largest subsidies. Medicare beneficiaries who do not meet these criteria but whose incomes are below 150 percent of the poverty line and whose assets are less than $10,000 for an individual or $20,000 for a couple will be eligible for a much smaller, but still significant subsidy. Individuals not receiving Medicaid or SSI who have assets of more than $10,000 for an individual or $20,000 for a couple are not eligible for a subsidy.

The new law requires that the definitions used in determining what income and assets are counted be modeled on SSI program rules. The Social Security Administration issued a notice of proposed rulemaking on March 4, 2005, spelling out the specific rules to be followed. SSA has explained in the proposed rule making that it intends to count as assets all liquid resources (defined as those that can be converted to cash within 20 days), including "retirement accounts (such as individual retirement accounts (IRA), 401(k) accounts), and similar items."

The Henry J. Kaiser Family Foundation recently issued a detailed study of the estimated effects of the asset test for these subsidies. The study found that the asset test for the low-income drug subsidies will disqualify about 2.4 million of the 14 million Medicare beneficiaries whose incomes are low enough to otherwise qualify for the subsidies.* About half of those whom the asset test will disqualify have relatively modest assets, the study reports.

The study also finds that approximately 70 percent of the individuals whom the asset test will disqualify have incomes below 135 percent of poverty. (The others have incomes between 135 percent and 150 percent of poverty.) The study reports that those who will meet the income criteria for the subsidies but be disqualified by the asset test "are disproportionately older widows who live alone." Some 13 percent of the aggregate assets of those who meet the income criteria but not the asset test are in 401(k)s, IRAs, Keoghs, or similar retirement accounts, according to the study.

Summary Table Adapted from Kaiser Study on Asset Test for Low-income Drug Subsidies

Low-Income Subsidy Levels	Monthly Premium	Annual Deductible	Copayments after the deductible is reached*
Dual eligibles receiving full Medicaid coverage who have income up to 100% of poverty ($9,570/individual in 2005)	$0	$0	$1/generic, $3/brand-name; no copays after total drug costs for covered drugs (including the portion of the costs that Medicare bears) reach $5,100 in a year
Dual eligibles receiving full Medicaid coverage who have income *above* 100% of poverty; SSI recipients who do not receive Medicaid; and dual eligibles who do not receive full Medicaid but for whom Medicaid pays the Medicare premiums	$0	$0	$2/generic, $5/brand-name; no copays after costs reach $5,100 in a year
Income below 135% of poverty ($12,920/individual) **and assets<$6,000/individual, <$9,000/couple**	$0	$0	$2/generic, $5/brand-name; no copays after costs reach $5,100 in a year
Other beneficiaries with income less than 150% of poverty ($14,355/individual in 2005) **and assets <$10,000/individual, <$20,000/couple**	sliding scale up to $37	$50	15% of drug costs up to the $5,100 annual limit; $2/generic, $5/brand-name thereafter
All other beneficiaries (people receiving no subsidy)	$37	$250	25% of drug costs up to the initial coverage limit ($2,250); 100% of drug costs above that limit until the $5,100 limit is reached; $2/generic, $5/brand-name (or 5% of drug costs, if higher) after that

* Copayments do not apply to dual eligibles who are institutionalized (e.g., in a nursing home).

The Kaiser study concludes:

> "The study's findings raise serious questions about the equity of the asset test. During their work years, Americans are encouraged to save for retirement and the possibility that they will face sizable long-term care expenses. Those to whom this message is most salient will have little or no income beyond what they receive from Social Security. By accumulating modest amounts of assets, either through bank accounts or retirement-savings vehicles, these same people have guaranteed that they will not qualify for the low-income Medicare drug subsidies — but the vast majority use prescription drugs every day. Using more common parlance, they find themselves in a 'Catch 22.' If they do save, they are disqualified from the subsidies. If they do not save, they will receive the subsidies but will have almost nothing to fall back upon besides their Social Security checks. And this burden tends to fall on the most vulnerable of seniors: older, low-income widows living alone."

These problems could be eased if the modifications regarding the treatment of retirement accounts under the SSI asset test that are proposed in the SSI section of this report were applied to the asset test for the low-income drug subsidies, as well.

See Thomas Rice, Katherine A. Desmond, *Low-Income Subsidies for the Medicare Prescription Drug Benefit: The Impact of the Asset Test,* The Henry J. Kaiser Family Foundation, April 2005, http://www.kff.org/medicare/7304.cfm. The quotations cited here are found on pages 21 and 27 of the study.

to operate. As a result of the tough fiscal environment that states have faced in the past few years, few states have used SCHIP funds to extend coverage to adults during this time. In the future, however, some additional states may wish to extend SCHIP coverage to parents or other adults. Ensuring that asset tests are not applied to these new populations, as they are not applied to children, would enable working parents who are covered under these programs to accrue retirement savings without fear of losing their health insurance coverage.

States also can take steps to disregard interest earned on retirement accounts from counting as income in determining eligibility for Medicaid or SCHIP. To effectuate such policies, states need simply to submit a state plan amendment to the Centers for Medicare and Medicaid Services.

For people who receive Medicaid based upon their age or disability, the issues are somewhat more complicated. As a starting point, to the extent that any changes are made in the rules of the federal SSI program, which are discussed in the next chapter, those changes will apply to people who are aged or disabled and categorically eligible for Medicaid because they receive SSI.[77] This could help low-income individuals with disabilities to retain retirement accounts so that the accounts are available to help support them in old age.

For the elderly population, states may have concerns about going beyond any changes made in SSI because of issues related to assets and asset transfers with regard to people who seek Medicaid to pay for their long-term care. This report does not attempt to address those issues.

For low-income people with disabilities, states also should consider ways to enable people who do not receive SSI to retain their retirement accounts while they are enrolled in Medicaid during periods when they are unable to work, as well as during periods when they are working but cannot get insurance through their employers.[78] This could be done by adopting proposals, such as those proposed in the SSI chapter of this report for SSI applicants and recipients, to disregard retirement accounts for people with disabilities who have not reached retirement age so that these accounts remain available to provide support to these individuals in old age.

Many states already are moving in this direction in their "Medicaid Buy-In" programs. Under these programs, states may permit people with disabilities who are working and need health care to apply for and obtain Medicaid coverage. States have substantial flexibility in setting the income and assets rules used in these programs. Eighteen of the thirty-two states that offer Medicaid Buy-In programs for people with disabilities have chosen to exclude retirement accounts from counting as assets.[79]

It also is important for such states to design their regular Medicaid programs so that individuals with disabilities whose retirement accounts were disregarded while they were working and participating in their state's Medicaid Buy-In program can retain their accounts if their conditions worsen and they must stop working for awhile and reenroll in regular Medicaid coverage. By not requiring liquidation of a retirement account at that time, the state not only would be providing the individual with some assurance about retirement income but also may be providing an incentive for the person to try to work again, since resumption of employment then could result in enlargement of the individual's retirement account without jeopardizing the individual's future eligibility for Medicaid if his or her condition should worsen again.

Supplemental Security Income

Program Overview

Established through legislation proposed by President Richard Nixon and enacted in 1972, the Supplemental Security Income (SSI) program is a means-tested, federally funded and federally administered program that provides cash benefits for low-income individuals who are aged, blind, or disabled.[80]

In January 2004, some 6.6 million individuals received monthly federal SSI checks.[81] Approximately 14 percent of the beneficiaries were children under 18 with disabilities, another 57 percent were individuals aged 18–64 with disabilities, and 29 percent were aged 65 or older.[82] The SSI program provided approximately $33 billion in federal cash assistance to these beneficiaries in 2003.[83]

SSI rules prescribe how various types and amounts of income and resources are treated in determining eligibility for the program. Individuals and couples are eligible for SSI benefits if their countable income falls below the maximum federal SSI benefit level, which is $579 a month for individuals and $869 a month for couples in 2005. Most, but not all, income that an applicant receives is considered in determining SSI eligibility.[84]

Some states provide a supplement to the SSI benefit for individuals who are aged, disabled, or blind. These state programs generally have somewhat higher income limits than the federal SSI program, so some individuals with incomes modestly above the maximum federal SSI benefit level may receive state supplemental benefits and also be eligible for Medicaid. (In most states, an individual who receives either SSI or a state SSI supplemental benefit is automatically eligible for Medicaid.)[85] State supplement programs typically use SSI income and asset rules, although in some states, these as well as certain other aspects of the eligibility rules are more restrictive than the rules applied in SSI.[86]

Treatment of Assets in SSI Eligibility Determinations

Rules regarding federal SSI eligibility and benefit levels are set by Congress and the Social Security Administration, which administers SSI. There is no state flexibility with regard to the treatment of assets in SSI. In general, eligibility for SSI is limited to individuals with no more than $2,000 in countable assets and couples with no more than $3,000.[87]

Some assets are *not* counted in determining SSI eligibility.[88] These include the beneficiary's home, one vehicle (if it is used for transportation for the individual or a member of the individual's household), up to $2,000 in household goods and personal items, and life insurance with a face value of less than $1,500.[89]

Treatment of Retirement Accounts in SSI

The SSI asset test is generally designed to exclude inaccessible resources and to count accessible resources. The Social Security Administration (SSA) looks to the terms of a retirement account to determine whether a person can access the account and take a lump-sum withdrawal, as well as whether the person is receiving or could receive periodic payments from the account. In its rules and policy guidance, SSA generally does not characterize various types of retirement savings plans by the names commonly associated with such plans (such as defined benefit plans and defined contribution plans). In this section, we apply SSA's principles regarding the treatment of retirement plans under the SSI program to retirement plans by type.

- Defined benefit pension plans, as well as a particular type of defined contribution plan known as a "money purchase plan,"[90] do *not* count as assets as long as individuals are employed by the firm that sponsors the plan because such individuals cannot access the plans and make withdrawals. (SSA does not require an

individual to terminate employment in order to access a retirement plan.)

Defined benefit plans generally do not count as assets if the individual is receiving regular payments from the plan. The payments count as income.[91]

- If an SSI applicant or recipient has the option at the time that the individual ceases to work for an employer of 1) making a lump-sum withdrawal from a retirement plan; 2) starting to receive periodic payments *immediately* from the plan; or 3) rolling over the retirement funds into an IRA or a new employer's retirement plan, SSA will require the person to take the periodic payments.[92] If, however, the periodic payments would not start until some point in the future (e.g., until the person reaches an age designated in the retirement plan), then SSA will count the amount of the lump sum as a resource. The person may take the lump-sum payment and spend most of the proceeds in order to qualify for SSI.[93] In that case, the person will qualify for SSI after the combination of the person's other countable assets and whatever is left of the person's retirement funds falls below the SSI asset limits of $2,000 for an individual and $3,000 for a couple.

- Stated another way, if an individual has a retirement plan from which he or she can make a lump-sum withdrawal now and the plan does not offer (or the individual does not elect) periodic payments that would start immediately, SSA will count the retirement account as an asset. The person thus must liquidate most or all of the account and spend the proceeds to qualify for SSI. This rule—that funds in a retirement account count against the SSI asset limits if the individual can withdraw the funds from the account (unless the individual arranges for periodic payments that start immediately)—applies regardless of whether the person must pay a penalty to withdraw the funds.[94] SSI policy states: "Since SSI is a current needs program, all sources of available support (unless otherwise excluded) are considered in determining eligibility. This is true even when current needs compel an individual to sacrifice future pension benefits."[95]

- A lifetime annuity that provides periodic payments for the rest of an individual's life usually does not count as an asset.[96] In purchasing such an annuity, the individual turns his or her assets over to the insurance company (or other firm selling the annuity); the individual relinquishes the assets in return for receipt of monthly payments as long as he or she lives. As a result, the individual no longer has a retirement account to access.

If an SSI applicant or recipient converts a retirement account into a lifetime annuity, SSA counts the monthly payments as unearned income.[97] If the sum of the person's income from the monthly annuity payments and his or her other income is at least $20 a month above the federal SSI monthly benefit level (or above the state's supplemental benefit level if the state has a SSI supplement), then the person will not be eligible for SSI (or for the state supplement).

Thus, to qualify for SSI, an individual with an IRA or a 401(k) or similar defined contribution plan must (unless the account is tiny) liquidate most or all of the account and spend the proceeds or else purchase a lifetime annuity that begins making periodic payments immediately. The only exception to this rule occurs in cases where a currently employed individual does not meet the conditions under which an employee may withdraw funds from the defined contribution plan in which he or she participates. Most SSI applicants and recipients would, however, meet the conditions under which withdrawals can be made because people with disabilities and certain other individuals may access their 401(k) accounts without penalties.[98]

Individuals Who Change Jobs or Otherwise Leave an Employer

For many years, if an individual had no more than $5,000 in a defined benefit or defined contribution plan and ceased to work for his or her employer, federal rules allowed the employer to require the individual to take his or her funds out of the retirement plan. The person could take a lump-sum payment or roll the funds over to an IRA (or, in some cases, to a retirement plan sponsored by the individual's new employer). Under a new federal rule that takes effect this year, if such an individual does not notify the employer of his or her choice, the employer may no longer force a lump-sum payment on the individual (unless the value of the funds or benefits is $1,000 or less). Starting this year, the employer will have two choices regarding the disposition of funds or benefits of between $1,000 and $5,000 when the employee gives no explicit directions: the employer can either retain the individual's funds in the individual's account in the employer's plan or the employer can roll over the funds to an IRA that the employer sets up for that individual with a financial institution.

In a situation in which an employee has between $1,000 and $5,000 in funds or benefits, if the former employee retains the ability to seek a lump-sum payment, the Social Security Administration will count the funds as an asset.[99] To receive SSI benefits, the person must take the lump-sum cash payment from his or her retirement plan and spend most of the proceeds (unless the amount involved is very small).

If an employee has accumulated *more than $5,000* by the time he or she leaves employment, the individual generally *may* take a lump-sum payment, but the employer cannot require the person to do so and thereby forgo future pension payments. However, SSA will count the amount of the lump-sum payment that is available as an asset even if the person does not take the lump-sum payment. As a result, to receive SSI, the individual must take the lump sum and spend it (unless the person receives regular pension payments starting immediately) and thereby forgo any future pension payments.

Problems That These Rules Pose for Low-Income People with Disabilities

These rules pose particular problems for SSI applicants and recipients who have disabilities. A working-age person with a disability who has a condition that enables the person to work periodically ought to be able to use his or her retirement account as a savings mechanism for retirement. Being compelled to liquidate the retirement account as a condition of receipt of SSI benefits during periods when the individual cannot work does not serve the individual's long-term needs. Moreover, being required to liquidate the account may remove an incentive for the individual to attempt to return to work—namely, the incentive to build savings for retirement by working and participating in a retirement plan.

The rules also pose other problems. Suppose an individual with a disability is managing to work for the time being but worries that, at some point, his or her medical condition will deteriorate to the point that he or she can work no longer and needs to apply for SSI and Medicaid. The SSI program's treatment of retirement accounts may discourage the individual from participating in his or her employer's retirement plan while he or she is working out of fear that doing so will jeopardize the individual's eligibility for SSI and Medicaid in the future.

In addition, for more than two decades, the SSI program has provided important help for individuals with disabilities who receive SSI and want to try to return to work. Under such circumstances, an SSI disability recipient can have a portion of his or her earnings disregarded and can move seamlessly through various

These rules pose particular problems for SSI applicants and recipients who have disabilities.

The Adverse Effects of Current SSA Policy

The following appears in the Social Security Administration policy instructions that govern the SSI program.

"F. EXAMPLE

"1. Situation

"Jeff Grant currently works 3 days a week for a company where he has been employed full-time for 20 years. Under his employer's pension plan, Mr. Grant has a $4,000 retirement fund. The CR [claims representative] confirms that Mr. Grant could withdraw the funds now, but there would be a penalty for early withdrawal and he would forfeit eligibility for an annuity when he stopped working.

"2. Analysis

"Since Mr. Grant can withdraw the retirement funds without terminating employment, they are a resource in the amount available after penalty deduction. This is true despite the fact Mr. Grant forfeits eligibility for periodic annuity payments in the future. Since SSI is a current needs program, all sources of available support (unless otherwise excluded) are considered in determining eligibility"

SSA POMS §SI 01120.210.F

protective SSI and Medicaid eligibility statuses. In 2003, more than 320,000 SSI recipients with disabilities or blindness were working. Some 71,000 of these individuals earned a sufficient amount that they no longer qualified for an SSI cash benefit but participated in a special SSI program that allowed their Medicaid coverage to continue.[100] To qualify either for a continuation of SSI cash benefits and Medicaid or for a continuation of Medicaid coverage only, the individual's countable assets must remain below the SSI asset limits of $2,000 for an individual or $3,000 for a couple. This generally means that such an individual cannot take advantage of the employer's defined contribution plan without risking loss of program benefits that may be critical to the person's ability to continue working.

In all these situations, the individual will not be saving for retirement. Yet if the individual had an account at retirement, it would provide an additional source of income that could reduce or even eliminate the individual's need for SSI at that time.

Problems for Low-Income Seniors

The rules also pose problems for poor elderly people who are ready to retire and wish to use funds they have accumulated in a modest retirement account to provide some income during their remaining years. If such an individual converts a retirement account to a lifetime annuity, SSA will not count it as an asset. But if the person finds that purchasing an annuity is not a financially wise choice—as will often be the case for low-income people, depending on their circumstances—SSA has no alternative mechanism to enable the individual to retain the retirement account and make periodic withdrawals from it without having the account count as an asset and make the person ineligible for SSI and, in most cases, for Medicaid as well.

These problems are compounded by the very low asset limits in SSI—$2,000 for an individual and $3,000 for a couple. These asset limits have remained unchanged since 1989, with no adjustment for inflation. When SSI was

implemented in 1974, the resource limits were $1,500 for an individual and $2,250 for a couple. Had these original amounts been indexed, the SSI resource limits in 2005 would be $5,885 and $8,828, respectively. The asset limits consequently are far more restrictive today than the limits were when the SSI program was established under the Nixon administration in the early 1970s.

Purchasing a Lifetime Annuity

Having a lifetime annuity often is very desirable. It ensures that income from retirement savings will not run out before a person dies.

There are several reasons, however, why it may be disadvantageous for a low-income elderly person who is not eligible

SSI Rules Can Penalize Recipients Who Seek to Protect Their Spouses from Poverty in Old Age

In most arrangements under which someone with a pension or retirement fund can receive a monthly annuity-like payment for the rest of his or her life, a married employee can receive either a higher monthly payment that ends when he or she dies (a "single life annuity") or a somewhat lower monthly amount that is payable until the employee dies and that is followed by a further reduced monthly amount (for example, one-half or two-thirds of the monthly amount payable during the employee's lifetime) that is payable to the employee's surviving spouse until the spouse's death. The "joint and survivor annuity" approach, under which payments continue to be made to the surviving spouse, has long been recognized as the approach that public policy should favor, as it reduces poverty among elderly widows, especially those who live to a very old age.

Indeed, federal law governing tax-qualified pension plans goes to great lengths to encourage and enforce such a public policy. A qualified plan can lose its tax-favored status for failure to provide that the joint and survivor annuity is the default mode of payment under the plan or for failure to protect the employee's spouse by ensuring that the spouse has a veto over the employee's choice to take a single-life annuity (or a lump-sum payment) instead of a joint and survivor annuity. This policy is considered so important that the Internal Revenue Code and ERISA (the Employee Retirement Income Security Act of 1974, as amended) explicitly provide that a spouse's consent to the employee's waiver of the joint and survivor annuity is not effective unless notarized or witnessed by a plan representative.

The rules that govern the SSI program, however, are contrary to this federal pension policy and push individuals to take annuities that end with their own death and consequently leave their widows (or widowers) with nothing. Under these rules, if an SSI recipient who has a pension or retirement fund has the choice of whether to take a higher monthly payment that ends when he dies or a lower monthly payment that continues until both the individual and spouse have died, *the recipient must take the higher benefit and eliminate the spouse's ability to receive payments after his death*. The SSI rules specifically state that SSA staff must "[a]dvise the SSI claimant/recipient that he/she must elect the higher current benefit to retain SSI eligibility. Election of the lower benefit will result in the loss of SSI eligibility until such time as the election is changed or the option for change is no longer available" (POMS SI 00510.001.D.3).

The SSI rules do state that SSA will not require the SSI applicant or recipient to take the higher monthly payment if the spouse refuses to waive his or her right to a spousal survivor benefit, but recipients and their spouses often will not know that this right exists. SSA rules do not require SSA staff to inform SSI applicants and recipients of the consequences that apply if the spouse declines to waive his or her right to the spousal survivor benefit.

to receive annuity payments through a defined benefit plan to purchase a lifetime annuity. If the person's health is poor and he or she has only a modest remaining life expectancy, purchase of an annuity would not be beneficial, as the annuity payments likely to be made before the person's death would not be sufficient to justify the purchase.

A lifetime annuity generally is not a wise investment for someone who is not expected to reach the average life expectancy for a retiree. Firms that sell annuities set prices and monthly annuity payment levels in accordance with the expectation that the people who choose to purchase these products will generally have *longer*-than-average life expectancy (since that is, in fact, the case). The purchase of a lifetime annuity can impose a loss on low-income people since they tend to have below-average life expectancy.

Historically, lifetime annuities purchased in the commercial market have also tended to be expensive, since the price of annuities reflects the administrative costs and profits of the firms that sell these products (see note 26). A low-income senior could reasonably conclude that the amounts that would be siphoned off in costs and fees would be better used to help cover his or her living expenses. In short, while a lifetime annuity is very desirable in many cases, especially if paid from a defined benefit plan (which avoids the need for an individual to purchase an annuity independently, with the attendant costs), it is inappropriate for the SSI program to force low-income elderly people who are not in a defined benefit plan and who wish to qualify for SSI to choose between purchasing an annuity that might be ill-advised for them financially and immediately spending most or all of their retirement funds.

Circumstances in Which Retirement Accounts Do *Not* Count

The Social Security Act requires that the income and assets of an ineligible spouse or an ineligible parent (or the spouse of such a parent) be "deemed" to be available to the SSI applicant or recipient. This means that the income and assets of the spouse or parent are treated as if they were the income and assets of the SSI applicant or recipient.[101]

The statute permits the SSA commissioner to determine if there are circumstances when such deeming would be inequitable and should not be required.[102] Relying upon this statutory language, the Commissioner of Social Security has ruled that retirement accounts of ineligible spouses, parents, or spouses of parents are *not* to be "deemed" to (i.e., not to be treated as though they were owned by) SSI applicants or recipients.[103] SSA has said it would be "inequitable to jeopardize the future of a person whose resources are deemed" by treating that person's future retirement income as though it belonged to another individual. SSA has characterized its policy of excluding retirement accounts from the deeming rules as being "supportive of families."

SSA distinguishes this situation from that in which the SSI applicant or recipient himself or herself has a retirement account. SSA has said, "SSI is a current needs-based program. Consequently, the individual's own current needs must outweigh his or her future needs."[104]

Opportunities for Policy Improvements

SSA's specific policies on the treatment of retirement accounts do not appear in, and are not required by, the Social Security Act. The statutory provision upon which SSA has relied in issuing these policies merely states that if a person has, or may potentially have, another source of income, the person must seek that income.[105] The income, if received, reduces the person's SSI benefits.

Over time, SSA has taken this principle—that an individual must pursue other available income—and applied it to very different circumstances, with some deleterious effects. SSA effectively requires an SSI-disability applicant or recipient to liquidate a retirement account as a

condition of receiving benefits, rather than allowing the person to retain the retirement account while receiving SSI so the account can provide income to the individual in old age. With the shift over the past several decades from defined benefit pension plans to defined contribution plans, what may initially have been a relatively benign extrapolation by SSA from the statutory language has turned into a perverse rule that threatens to disinvest many low-income working-age people with disabilities of their modest retirement savings (or to prevent them from establishing a retirement account in the first place), and thereby to leave them less well prepared for their retirement years.

Some people with disabilities experience periods when they cannot work and need full SSI benefits, followed by periods when they can return to work and go off SSI until their medical conditions worsen. Such individuals should not have to liquidate their retirement accounts when they need to return to SSI. Other people with disabilities can work while remaining eligible for SSI; they should be permitted to establish and build retirement accounts.

Similar issues arise with regard to poor elderly individuals who have modest retirement accounts. The current rules effectively require such individuals to liquidate their accounts and spend the proceeds as a condition of receiving SSI, unless they purchase a lifetime annuity. A more sensible policy would allow them to retain their accounts but require them to draw reasonable amounts of income from the accounts on a regular basis or deem them to be making such withdrawals for purposes of the income test.
Because important aspects of SSA's current policy are not mandated by statute, SSA does not need a legislative change to modernize and improve the policy. SSA has the opportunity to redesign its policy to encourage saving for retirement and, where possible, a return to work. Such a change in policy could reduce some individuals' need for SSI in old age, by enabling them to receive income in old age from their retirement accounts and thus to be able to rely to a greater degree in retirement upon a combination of Social Security and income from retirement savings.

How to Proceed

The SSA rule discussed above on the deeming of assets reflects the tension between two policy goals—the need on the one hand to ensure that SSI is a program of last resort (the "current needs-based" policy) and the importance on the other hand of not "jeopardiz[ing] the future" and of encouraging individuals to save for retirement. SSA's rule excluding the retirement accounts of ineligible spouses and parents is intended to avoid jeopardizing the future of the relatives of SSI recipients and to encourage the relatives to save for their own retirement. In addition, SSA's policy

Protecting Against Unintended Consequences in Medicaid

The federal Medicaid statute permits some states to maintain Medicaid eligibility rules for SSI recipients that are more restrictive than the SSI eligibility rules. This means that SSI recipients in these states are not automatically eligible for Medicaid. Eleven states follow these procedures. They are known as "209(b)" states. (The states are listed in note 60.)

Reforms in the treatment of retirement accounts in SSI would not automatically apply to the Medicaid eligibility rules for SSI recipients in these states. If SSA makes changes in the SSI rules, it will be important to encourage these states to make similar changes in their state Medicaid rules so that an SSI recipient who benefits from being able to retain a retirement account for use in retirement will not lose eligibility for Medicaid by retaining the account. For many people who receive SSI, the health care they receive through the Medicaid program is as important as—and, in many cases, more valuable than—their SSI cash benefit.

SSA or Congress should modify the SSI rules to exclude retirement accounts from counting as assets and to count as income in retirement the monthly annuity value of such accounts.

of excluding lifetime annuities from the SSI asset test reflects an understanding that ongoing periodic payments are preferable to one-time lump-sum payments. These policies provide SSA a framework upon which to build in improving SSI policies related to retirement saving.

Further, SSA policies instituted in recent years emphasize helping and encouraging SSI recipients with disabilities to return to work or to continue working. This is a key emphasis both at SSA and of President Bush's "New Freedom Initiative."[106] This emphasis provides additional grounds for reassessing and modifying the policy on the treatment of retirement accounts in the SSI program. A change in policy to exclude retirement accounts for working-age people with disabilities from being counted as assets would support efforts to encourage people with disabilities to attempt to return to work and, once working again, to remain employed. It would provide an additional incentive to work—the incentive to build retirement savings without jeopardizing an individual's ability to return to SSI and Medicaid if the individual's condition should worsen and he or she cannot continue employment.

Such an approach would be consistent with the choices many states have made in designing their Medicaid Buy-In programs. As noted in the Medicaid chapter of this report, under these programs, states may permit people with disabilities who are working and need health care to apply for and secure Medicaid coverage. States have substantial flexibility in setting the income and assets rules used. Eighteen of the thirty-two states that exercise this option have chosen to exclude retirement accounts from counting as assets in their Medicaid Buy-In programs.[107]

Another point worth noting is that requiring SSI applicants and recipients to liquidate their retirement accounts may often generate little savings for the SSI program. If a person receives a lump-sum payment upon liquidation of a retirement account, SSA will not count the payment as income in the month it is received, but will count as an asset whatever portion of the lump-sum amount remains, starting in the first month after receipt of the payment.[108] If the remaining amount, when combined with other countable assets, exceeds the asset limit of $2,000 for an individual and $3,000 for a couple, the person will remain ineligible for SSI. This provides an incentive for individuals to use most or all of the funds from a retirement savings account to pay off accumulated bills, purchase an excludable resource such as a vehicle, undertake deferred home or automobile repairs, replace a household appliance, or the like. When this occurs, ineligibility for SSI can last for only a short period of time, and the savings to the SSI program are limited to a few months of benefits. Accordingly, changing the policy may have a modest cost.

In fact, if individuals were allowed to retain their retirement accounts, the future income from those accounts could reduce the cost of the individuals' SSI checks in retirement or make the individuals ineligible for SSI at that time because their income would exceed the SSI income limit. This could occur, for example, if an SSI disability recipient with a small retirement account were able to hold on to the account and to return to work at a subsequent point, which would provide an opportunity for the retirement account to grow. Upon retiring, the person might be able to rely upon Social Security, Medicare, and funds from the retirement account without needing SSI or Medicaid. Even if the person still needed SSI, his or her benefits would be lower in old age than would otherwise be the case because of the income that he or she would receive from the retirement account.

The Specific Changes That Should Be Made

Accordingly, there are three administrative rule changes that SSA should seriously

consider. These changes would markedly improve the ability of people who have disabilities or are aged—and who need SSI—to retain retirement savings and use those savings to provide income in old age.

- First, SSA or Congress should modify the SSI rules to exclude retirement accounts from counting as assets and to count as income in retirement the monthly annuity value of such accounts. This would entail broadening the current exclusion for retirement accounts held by ineligible spouses and parents to include retirement accounts held by working-age people with disabilities. Such a rule could include language stating that any amounts that individuals with disabilities withdraw from such accounts prior to age 65, and while receiving SSI, will be treated as countable income in SSI.

  It should be noted that the Social Security Administration cannot change through administrative action the requirement that as a condition of receiving SSI, a disabled SSI beneficiary who can begin to draw a regular payment from a retirement fund immediately must do so, even if beginning to draw payments now will mean that the payments will be significantly smaller than if the person waited until he or she reached the age the retirement plan designates for receipt of such payments.[109] As explained earlier, the SSI statute requires that a person apply for and obtain any benefits or income for which he or she is eligible.[110] (Given the retirement savings issues that are involved, Congress may wish to consider whether there should be an exception to the current statutory language in cases where electing *not* to take immediate regular payments would result in a more substantial stream of regular income in old age.)

  The statutory provision in question requires a person to apply for and secure *ongoing* income. It does not bind SSA in cases when all that the person can receive is a lump-sum payment. SSA now applies the policy in such a situation, as well, but it would be better public policy to permit an SSI disability beneficiary to retain retirement funds and *not* have those funds affect eligibility for SSI, as long as the person does not withdraw those funds. At the time the person retires or reaches age 65, the person would have the same choices as SSI elderly applicants and recipients concerning whether to retain the retirement account or convert it to an annuity. The person thus would have additional income in retirement that would reduce or eliminate the need for SSI. This is a step that SSA can and should take administratively.

- Second, SSA should amend its rules to provide that a person age 65 or older need not convert his or her retirement account into a lifetime annuity to have it excluded from the SSI asset test; instead the principle should be that retirement accounts will not count as assets for aged SSI recipients but that SSA will count as income the amount of money the person could take from such an account on a monthly basis for the remainder of his or her life. To enable SSA to implement such a rule, the Social Security Administration's actuaries would provide a table with monthly annuity amounts, based on the value of an account and an individual's age. (This would be easy for the actuaries to do and would reflect life-expectancy projections the actuaries already make.) SSA staff would take an individual's age and the value of his or her retirement account and simply look up on the table the annuity value of the account. The amount shown on the table would be counted as unearned income in determining SSI eligibility and benefit levels.[111]

  SSA redetermines the income and asset eligibility of SSI recipients on an annual basis. As part of this process, SSA could check to see if an adjustment in

SSA should amend its rules to ensure that the rights of spouses to a pension after the death of the worker are protected.

the amount being imputed as income from a recipient's retirement account is needed to reflect changes either in life expectancy (since the person will have lived for another year) or in the value of the person's account.

This approach would have the salutary effect of allowing older people to retain rather than liquidate their retirement funds, without having to reduce the value of their accounts to purchase a lifetime annuity that might not be appropriate for them. Those who wished to purchase a lifetime annuity would still be able to do so, with their monthly annuity payments counting as income, as under the current rules.

Such changes also could be made through legislation. For example, pension legislation introduced by then-Rep. Rob Portman (R-Ohio) and Rep. Ben Cardin (D-Maryland) in 2003 included reforms consistent with the principles outlined here. Under the legislation, the first $75,000 in a retirement account would not be counted against the SSI asset limit. A monthly annuity value would be computed for the balances in such accounts for applicants and recipients who are aged 60 1/2 and over, based on a table that SSA would issue, with the monthly annuity value being counted as income.[112]

- Finally, SSA should amend its rules to ensure that the rights of spouses to a pension after the death of the worker are protected. As explained in the box on page 29, current SSA rules require an SSI recipient to take a higher monthly pension payment that terminates when the recipient dies (a single-life annuity), instead of taking a lower monthly pension payment with the guarantee that the person's spouse will continue to receive benefits until the spouse dies if the recipient should die first (a joint and survivor annuity). SSA's rules conflict with other federal policy that seeks to protect spouses in these situations, and these rules are likely to harm needy, uninformed couples. (If the spouse *knows* to refuse to waive his or her right to benefits, SSA drops the matter.) The SSA rule should be changed to eliminate the current requirement, or better still, to provide that it is SSA's policy to encourage SSI recipients to take the lower (joint and survivor) pension benefit in order to ensure protection for the spouse until the spouse dies.

Conclusion

Federal law reflects a national interest in increasing retirement saving by low- and moderate-income households, and policymakers have expressed interest on a bipartisan basis in making further progress toward this goal. Doing so would help reduce elderly poverty, increase national saving rates, reduce the number of elderly people who need to rely upon means-tested programs in retirement, and make federal investments in subsidizing retirement savings less regressive. Policymakers and administrators of means-tested benefit programs can play an important role in increasing retirement saving by low-income families by eliminating or modifying asset rules that affect program eligibility.

Congress could create a blanket disregard for retirement accounts that receive preferential tax treatment (such as 401(k) plans and IRAs) by amending the tax code to exclude such accounts when determining eligibility or benefit levels under federal means-tested programs. Even in the absence of such a change, states have complete flexibility in TANF programs, Medicaid, and SCHIP with regard to asset rules. To facilitate retirement saving, state policymakers and administrators could eliminate asset tests entirely in those programs or could disregard retirement plans when applying asset tests.

At a minimum, states should disregard 401(k) and similar employer-based retirement plans in these programs and

also should disregard IRAs to the extent that forthcoming federal food stamp regulations permit. Such a policy would align the treatment of defined contribution plans like 401(k) plans with the treatment of defined benefit plans, which are disregarded when asset tests are applied. This policy also would conform to the treatment of retirement plans under the Food Stamp Program. (In the Food Stamp Program, states must disregard 401(k)s and similar plans.) Taking advantage of this flexibility would allow states to simplify program administration by establishing a uniform rule across several major benefit programs that disregards savings in employer-based retirement plans.

In the SSI program, which operates under federal rules, policymakers have an opportunity to make administrative changes to treat different kinds of retirement plans more fairly and to allow more people with disabilities to save adequately for retirement. Within the limits of the current statute, the Commissioner of Social Security should change SSA policy to permit SSI applicants and recipients to retain retirement accounts prior to age 65 and not have them count as resources. For those 65 or older, including those who previously received SSI based on disability or blindness, SSA should change its rules to allow individuals to retain their retirement accounts rather than having to purchase an annuity, while requiring that the monthly annuitized value of such an account be deemed to be income to the individual. Congress also could make such changes through legislation, perhaps along the lines of the Portman-Cardin proposal introduced in 2003. (In addition, in situations in which an individual with a disability is under age 65 and is eligible to receive a periodic payment from a retirement fund or account, Congress could consider whether it would be better public policy to allow the individual to postpone receipt of payments from the retirement accounts until he or she reaches 65, when the payments would be more substantial and could reduce the person's need for SSI.)

Eliminating or changing asset rules will have modest costs, because some low-income households that otherwise would have been precluded from receiving means-tested benefits will be able to secure benefits to see them through a time of need. Such an investment would be well worth it. If low-income households can save more adequately for retirement, the economy as a whole should benefit from increased national saving, and fewer people will be poor and have to rely on public benefits in old age. Moreover, the costs would be tiny compared with the costs that the federal government bears in providing extensive tax subsidies for retirement saving that accrue primarily to higher-income households.

Asset Limits and Treatment of Retirement Accounts In Medicaid for Children and Families and in SCHIP

State	Children's Medicaid and SCHIP	Family Medicaid	Family Medicaid	Family Medicaid
	Asset Limit[a,b] (family of three)	Asset Limit[b] (family of three)	Is the First Vehicle Counted As an Asset?[b]	Are Retirement Accounts Counted As an Asset?[b]
Alabama	None	None	Not applicable	Not applicable
Alaska	None	$2,000	No	Yes
Arizona	None	None	Not applicable	Not applicable
Arkansas	None	$1,000	No	Yes
California	None	$3,150	No, if used for certain purposes[c]	IRAs and Keogh plans are counted; 401(k)s are not counted
Colorado	Medicaid: $1,000 SCHIP: None	$2,000	No	Yes
Connecticut	None	None	Not applicable	Not applicable
Delaware	None	None	Not applicable	Not applicable
District of Columbia	None	None	Not applicable	Not applicable
Florida	None	$2,000	$8,500 of value is not counted	Yes
Georgia	None	$1,000	No, if primarily used for income-producing purposes[d]	Yes
Hawaii	None	$3,250	No	Yes
Idaho	Medicaid: $5,000 SCHIP: $5,000	$1,000	No	Only withdrawn funds are counted
Illinois	None	None	Not applicable	Not applicable
Indiana	None	$1,000	$5,000 of value is not counted	Yes
Iowa	None	$2,000	$4,115 of value not counted	Yes
Kansas	None	None	Not applicable	Not applicable
Kentucky	None	$2,000[e]	No	Only withdrawn funds are counted
Louisiana	None	None	Not applicable	Not applicable
Maine	None	$2,000, but $12,000 of savings are not counted	No	Yes
Maryland	None	$3,000	No	IRAs and Keogh plans are counted; 401(k)s are not counted
Massachusetts	None	None	Not applicable	Not applicable
Michigan	None	$3,000[e]	No	Yes[f]
Minnesota	None	$20,000	No	No
Mississippi	None	None	Not applicable	Not applicable
Missouri	None	None	Not applicable	Not applicable
Montana	Medicaid: $3,000 SCHIP: none	$3,000	Vehicle with the highest equity is not counted	Yes
Nebraska	None	$6,000	No	Yes
Nevada	None	$2,000	No	Yes

State	Children's Medicaid and SCHIP	Family Medicaid	Family Medicaid	Family Medicaid
	Asset Limit[a,b] (family of three)	Asset Limit[b] (family of three)	Is the First Vehicle Counted As an Asset?[b]	Are Retirement Accounts Counted As an Asset?[b]
New Hampshire	None	$1,000	No	Yes
New Jersey	None	None	Not applicable	Not applicable
New Mexico	None	None	Not applicable	Not applicable
New York	None	$3,000 (the asset limit is $1,000 but the first $2,000 in assets are not counted)[g]	No	Yes
North Carolina	None	$3,000	No	Only withdrawn funds are counted
North Dakota	None	None	Not applicable	Not applicable
Ohio	None	None	Not applicable	Not applicable
Oklahoma	None	None	Not applicable	Not applicable
Oregon	Medicaid: none SCHIP: $10,000	$2,500, but up to $10,000 if participating in a TANF work activity	No	Yes
Pennsylvania	None	None	Not applicable	Not applicable
Rhode Island	None	None	Not applicable	Not applicable
South Carolina	None	None	Not applicable	Not applicable
South Dakota	None	$2,000	No	Yes
Tennessee	None	$2,000	$4,600 of value is not counted	Yes
Texas	Medicaid: $2,000 SCHIP: $5,000 if income is above 150% of poverty line; otherwise, none	$2,000	$4,650 of value is not counted	IRA and Keogh plans are counted; funds withdrawn from a 401(k) are counted (remaining funds are not counted)
Utah	Medicaid: $3,025 if child is age 6 or older; otherwise none SCHIP: none	$3,025[h]	No	Yes
Vermont	None	$3,150[i]	No	Yes
Virginia	None	None	Not applicable	Not applicable
Washington	None	$1,000	$5,000 of value is not counted	Yes
West Virginia	None	$1,000	$1,500 of value is not counted	Yes
Wisconsin	None	None	Not applicable	Not applicable
Wyoming	None	None	Not applicable	Not applicable

a. See *Beneath the Surface: Barriers Threaten to Slow Progress on Expanding Health Coverage of Children and Families*, Donna Cohen Ross and Laura Cox, Center on Budget and Policy Priorities for the Kaiser Commission on Medicaid and the Uninsured, October 2004, table 5, available at http://www.kff.org/medicaid/7191.cfm.

b. Based on a national survey conducted by the Center on Budget and Policy Priorities in 2004 that asked about resource limits and rules, including the treatment of IRAs, 401(k)s, and Keogh plans. States that count a particular kind of retirement account, generally do so only if the account is in some way accessible to the client. Some states do not count Keogh plans that involve a contractual relationship with individuals outside of the household.

c. If the value of the first vehicle is counted, California disregards $1,500 of its equity value.

d. If the value of the first vehicle is counted, Georgia disregards $4,650 of its equity value.

e. Michigan counts only liquid assets.

f. Michigan counts 401(k) plans, Keogh plans, and IRAs even if they are not accessible to the client; defined benefit plans are counted only if accessible to the client.

g. There is no asset test in New York's expanded Medicaid program for parents, known as Family Health Plus.

h. There is no asset test in Utah's expanded Medicaid program for parents, known as the Primary Care Network Program.

i. There is no asset test in Vermont's expanded Medicaid program for parents, known as the Vermont Health Access Program.

Asset Limits In Medicaid for People Who Are Elderly, Blind, or Disabled

State	Mandatory SSI or 209(b) Coverage Category[a] — Asset Limit (individual)[b]	Mandatory SSI or 209(b) Coverage Category[a] — Asset Limit (couple)[b]	Optional Medically Needy Coverage Category[c] Asset Limit (individual)[d]	Optional Medically Needy Coverage Category[c] Asset Limit (couple)[d]	Optional Poverty-Level Coverage Category[e] — Asset Limit (individual)[f]
Alabama	$2,000	$3,000	No coverage	No coverage	No coverage
Alaska	$2,000	$3,000	No coverage	No coverage	No coverage
Arizona	$2,000	$3,000	No coverage	No coverage	No coverage
Arkansas	$2,000	$3,000	$2,000	$3,000	No coverage
California	$2,000	$3,000	$2,000	$3,000	$2,000
Colorado	$2,000	$3,000	No coverage	No coverage	No coverage
Connecticut	$1600	$2,400	$1,600	$2400	No coverage
Delaware	$2,000	$3,000	No coverage	No coverage	No coverage
District of Columbia	$2,000	$3,000	$2,600	$3,000	$2,000
Florida	$2,000	$3,000	$5,000	$6,000	$5,000
Georgia	$2,000	$3,000	$2,000	$4,000	No coverage
Hawaii	$2,000	$3,000	$2,000	$3,000	$2,000
Idaho	$2,000	$3,000	No coverage	No coverage	No coverage
Illinois	$2,000	$3,000	$2,000	$3,000	$2,000
Indiana	$1,500	$2,250	No coverage	No coverage	No coverage
Iowa	$2,000	$3,000	$10,000	$10,000	No coverage
Kansas	$2,000	$3,000	$2,000	$3,000	No coverage
Kentucky	$2,000	$3,000	$2,000	$4,000	No coverage
Louisiana	$2,000	$3,000	$2,000	$3,000	No coverage
Maine	$2,000	$3,000	$2,000	$3,000	$2,000
Maryland	$2,000	$3,000	$2,500	$3,000	No coverage
Massachusetts	$2,000	$3,000	$2,000[g]	$3,000[g]	$2,000
Michigan	$2,000	$3,000	$2,000	$3,000	$2,000
Minnesota	$3,000	$6,000	$3,000	$6,000	$3,000
Mississippi	$2,000	$3,000	No coverage	No coverage	$2,000
Missouri	$999.99	$2,000	No coverage	No coverage	No coverage
Montana	$2,000	$3,000	$2,000	$3,000	No coverage
Nebraska	$2,000	$3,000	$4,000	$6,000	$4,000
Nevada	$2,000	$3,000	No coverage	No coverage	No coverage
New Hampshire	$1,500	$1,500	$2,500	$4,000[h]	No coverage
New Jersey	$2,000	$3,000	$4,000	$6,000	$2,000

State	Mandatory SSI or 209(b) Coverage Category[a] — Asset Limit (individual)[b]	Mandatory SSI or 209(b) Coverage Category[a] — Asset Limit (couple)[b]	Optional Medically Needy Coverage Category[c] Asset Limit (individual)[d]	Optional Medically Needy Coverage Category[c] Asset Limit (couple)[d]	Optional Poverty-Level Coverage Category[e] — Asset Limit (individual)[f]
New Mexico	$2,000	$3,000	No coverage	No coverage	No coverage
New York	$2,000	$3,000	$3,750	$5,400	No coverage
North Carolina	$2,000	$3,000	$2,000	$3,000	$2,000
North Dakota	$3,000	$6,000	$3,000	$6,000	No coverage
Ohio	$1,500	$2,250	No coverage	No coverage	No coverage
Oklahoma	$2,000	$3,000	$2,000	$3,000	$2,000
Oregon	$2,000	$3,000	$2,000	$3,000	No coverage
Pennsylvania	$2,000	$3,000	$2,400	$3,200	$2,400
Rhode Island	$2,000	$3,000	$4,000	$6,000	$4,000
South Carolina	$2,000	$3,000	No coverage	No coverage	Not available
South Dakota	$2,000	$3,000	No coverage	No coverage	No coverage
Tennessee	$2,000	$3,000	$2,000	$3,000	No coverage
Texas	$2,000	$3,000	No coverage	No coverage	No coverage
Utah	$2,000	$3,000	$2,000	$3,000	$2,000
Vermont	$2,000	$3,000	$2,000	$3,000	No coverage
Virginia	$2,000	$3,000	$2,000	$3,000	$2,000
Washington	$2,000	$3,000	$2,000	$3,000	No coverage
West Virginia	$2,000	$3,000	$2,000	$3,000	No coverage
Wisconsin	$2,000	$3,000	$2,000	$3,000	No coverage
Wyoming	$2,000	$3,000	No coverage	No coverage	No coverage

a. States are required to provide Medicaid coverage to SSI recipients, in which case the SSI asset limits of $2,000 for an individual and $3,000 for a couple apply. As an alternative to covering all SSI recipients, under section 209(b) of the Social Security Act Amendments of 1972, some states are permitted to cover only those SSI recipients who meet the income and asset tests that were in place in 1972 when SSI was enacted. States that take up this option are known as 209(b) states, and their asset limits may be lower than the SSI asset limit.

b. See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, table 4, available at http://research.aarp.org/health/2003_14_abd.html, and the National Association of State Medicaid Directors' *Aged, Blind, and Disabled Medicaid Eligibility Survey*, available at http://www.nasmd.org/eligibility/results3.asp.

c. States are permitted to provide Medicaid coverage to low-income elderly or disabled people who have high medical costs but too much income to qualify for Medicaid in another eligibility category. Applicants can qualify for coverage under this category, known as the "medically needy" category, if they have income below the income limit for this category or if they incur high out-of-pocket medical expenses and their income drops below the limit when these expenses are subtracted from it. (This is known as "spending down.")

d. See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, table 7, available at http://research.aarp.org/health/2003_14_abd.html, and the National Association of State Medicaid Directors' *Aged, Blind, and Disabled Medicaid Eligibility Survey*, available at http://www.nasmd.org/eligibility/results6.asp.

e. States have the option of providing Medicaid coverage to elderly and/or disabled people with incomes up to the poverty line who are not SSI recipients.

f. See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, table 6, available at http://research.aarp.org/health/2003_14_abd.html.

g. Massachusetts does not apply an asset test to noninstitutionalized blind or disabled applicants under the age of 65.

h. The asset limit for *disabled* couples in New Hampshire who are in this category is $2,500.

Appendix C

Where to Find More Information on State Asset Policies

The Food Stamp Program

State policy manuals (which may explain the treatment of retirement savings):

Online Information about Key Low-Income Benefit Programs—Links to Policy Manuals, Descriptive Information, and Applications for State Food Stamp, TANF, Child Care, Medicaid, and SCHIP Programs, Sharon Parrott, Center on Budget and Policy Priorities, updated November 29, 2004, available at http://www.cbpp.org/1-14-04tanf.pdf.

Temporary Assistance for Needy Families

State TANF cash assistance asset limit and vehicle rules:

Temporary Assistance for Needy Families (TANF) Sixth Annual Report to Congress, U.S. Department of Health and Human Services, November 2004, chapter 12, table 12:6, available at http://www.acf.hhs.gov/programs/ofa/annualreport6/ar6index.htm.

State treatment of assets held by children:

Urban Institute's Welfare Rules Database at http://anfdata.urban.org/WRD/WRDWelcome.CFM.

State TANF plans:

Links are available at http://www.financeprojectinfo.org/win/tanf.asp.

State policy manuals (which may explain the treatment of retirement savings):

Online Information about Key Low-Income Benefit Programs—Links to Policy Manuals, Descriptive Information, and Applications for State Food Stamp, TANF, Child Care, Medicaid, and SCHIP Programs, Sharon Parrott, Center on Budget and Policy Priorities, updated November 29, 2004, available at http://www.cbpp.org/1-14-04tanf.pdf.

Medicaid

State Medicaid plans:

Links and a search function are available at http://www.cms.hhs.gov/medicaid/stateplans/.

State policy manuals (which may explain the treatment of retirement savings):

Online Information about Key Low-Income Benefit Programs—Links to Policy Manuals, Descriptive Information, and Applications for State Food Stamp, TANF, Child Care, Medicaid, and SCHIP Programs, Sharon Parrott, Center on Budget and Policy Priorities, updated November 29, 2004, available at http://www.cbpp.org/1-14-04tanf.pdf.

Endnotes

[1] Peter R. Orszag is Director of The Retirement Security Project, the Joseph A. Pechman Senior Fellow in Tax and Fiscal Policy at the Brookings Institution, and Co-Director of the Urban-Brookings Tax Policy Center.

[2] This is not the case in the Supplemental Security Income program, which has national standards. A list of resources to find more information on state policies in specific means-tested programs appears in appendix C.

[3] The descriptions of various retirement savings vehicles are primarily drawn from *Utilization of Tax Incentives for Retirement Saving*, Congressional Budget Office, August 2003, available at http://www.cbo.gov/ftpdocs/44xx/doc4490/08-07-Retirement.pdf.

[4] Some plans are considered hybrids and have features of both defined benefit and defined contribution plans.

[5] In each year from 1975 through 1997, between 45 percent and 47 percent of private-sector workers participated in a defined-benefit or defined-contribution plan. See *Utilization of Tax Incentives for Retirement Saving*, Congressional Budget Office, August 2003, figure 1, available at http://www.cbo.gov/ftpdocs/44xx/doc4490/08-07-Retirement.pdf. Public-sector coverage rates tend to be higher.

[6] Ibid., p. 4.

[7] The cap is $14,000 in 2005 for participants under age 50. The limit will increase by $1,000, to $15,000, in 2006. Participants aged 50 and older may make additional contributions.

[8] See *Utilization of Tax Incentives for Retirement Saving*, Congressional Budget Office, August 2003, table 4, available at http://www.cbo.gov/ftpdocs/44xx/doc4490/08-07-Retirement.pdf.

[9] Under current law, participants age 50 and older are allowed to make additional contributions.

[10] A married individual who participates in an employment-based pension plan may not deduct contributions to a traditional IRA if the couple's joint income equals or exceeds $80,000 in 2005. This figure will increase to $85,000 in 2006 and will be $100,000 for 2007 and later years. (If a taxpayer does not participate in an employment-based pension plan but the taxpayer's spouse does, the taxpayer may not deduct contributions to a traditional IRA if the couple's joint income equals or exceeds $160,000.) The income limits are higher for Roth IRAs. A married individual may not use a Roth IRA if his or her income equals or exceed $160,000. These income limits do not affect households eligible for the means-tested benefits discussed in this paper because their household incomes are far below these levels.

[11] See 26 U.S.C. §72(t).

[12] In addition, many 401(k) plans allow loans. Loans are not treated as withdrawals so long as 1) the amount of the loan is less than a certain percentage of the amount in the individual's account; and 2) the loan is repayable within five years through regular payments made at least quarterly. (There is an exception for loans used to purchase a home.) However, if a borrower defaults on a loan or leaves employment with a loan balance outstanding, the loan is treated as a withdrawal. See 26 U.S.C. §72(p).

[13] See, for example, *Do Welfare Asset Limits Affect Household Saving? Evidence from Welfare Reform*, Erik Hurst and James P. Ziliak, National Bureau of Economic Research, Working Paper 10487, May 2004.

[14] See *Progressivity and Government Incentives to Save*, Peter Orszag and Robert Greenstein, prepared for Harvard University's Kennedy School of Government conference on "Building Assets, Building Credit," November 2003, table 2.

[15] See *Toward Progressive Pensions: A Summary of the U.S. Pension System and Proposals for Reform*, Peter Orszag and Robert Greenstein, prepared for Washington University's conference on "Inclusion in Asset Building: Research and Policy Symposium," September 2000, p. 6.

[16] Ibid., p. 10.

[17] See *Progressivity and Government Incentives to Save*, Peter Orszag and Robert Greenstein, prepared for Harvard University's Kennedy School of Government conference on "Building Assets, Building Credit," November 2003, p. 3.

[18] See *Saving Social Security*, Peter A. Diamond and Peter R. Orszag, Brookings, 2004, table 8, p. 139.

[19] *Budget of the United States, Fiscal Year 2005, Analytical Perspectives*, table 18-1.

[20] See *Distributional Effects of Defined Contribution Plans and Individual Retirement Accounts*, Leonard Burman, William Gale, Matthew Hall, and Peter Orszag, The Urban-Brookings Tax Policy Center, August 2004.

[21] For a more in-depth discussion of research on the relationship between asset tests and saving rates, see *The Effect of Asset Tests on Saving*, Gordon McDonald, Peter R. Orszag, and Gina Russell, The Retirement Security Project, June 2005, available at http://retirementsecurityproject.org.

[22] The exemption for the Earned Income Tax Credit appears at 26 U.S.C. §32(1). The child tax credit exemption is included in Section 203 of the Economic Growth and Tax Relief Act of 2001.

[23] Individual Development Accounts funded under either the Assets for Independence Act (AFIA) or the Temporary Assistance for Needy Families block grant (TANF) are excluded from being counted as income or assets in determining eligibility for any federally-funded means-tested benefit. The AFIA provision was amended in 2000 and appears at 42 U.S.C. §604 note. The provision states: "Notwithstanding any other provision of federal law (other than the Internal Revenue Code of 1986) that requires consideration of 1 or more financial circumstances of an individual, for the purpose of determining eligibility to receive, or the amount of, any assistance or benefit authorized by such law to be provided to or for the benefit of such individual, funds (including interest accruing) in an individual development account under this Act shall be disregarded for such purpose with respect to any period during which such individual maintains or makes contributions to such an account." The TANF provision, enacted as part of the welfare reform legislation in 1996, includes virtually identical language. 42 U.S.C. §604(h)(4).

[24] Under federal law, if an individual has less than $5,000 in a defined benefit or defined contribution plan and leaves his or her employer, the employer can require the individual to take his or her funds out of the retirement plan. Under a new federal rule that took effect in March 2005, if such an individual does not notify the employer of his or her choice, if the amount is greater than $1,000, and if the terms of the plan allow funds to be removed, the employer must roll over the individual's funds into an IRA for that individual (unless the employer retains the funds in the employer's plan).

[25] Life annuities generally are regular monthly or annual payments that are guaranteed to continue for the individual's lifetime (or the lifetimes of an individual *and* the individual's spouse). They can be provided by a defined benefit plan or purchased from an insurance company or other financial institution that contracts to provide such an annuity. An annuity that is not a life annuity might be payable for a fixed number of years rather than for life; with an annuity that is not a lifetime annuity, or when someone does not purchase an annuity and instead makes regular withdrawals from a retirement account, there is a risk that the savings will run out before the retiree dies.

[26] When an individual converts a retirement account to a lifetime annuity, the value of the savings in the account are likely to be reduced by roughly 3 to 5 percent to cover the annuity company's marketing expenses, commissions to agents, other administrative costs, and profits. The value of the savings in the account are likely to be reduced roughly another 10 percent to reflect the fact that people who purchase annuities tend to have longer-than-average life expectancies, and firms that sell annuities price the annuities to reflect that reality. See *Mortality Risk, Inflation Risk, and Annuity Products*, Jeffrey Brown, Olivia Mitchell, and James Poterba, National Bureau of Economic Research, Working Paper 7812, July 2000.

[27] See *Who Are the Asset Poor?: Levels, Trends, and Composition, 1983–1998*, Robert Haveman and Edward N. Wolff, Institute for Research on Poverty, University of Wisconsin, Discussion Paper no. 1227-01, April 2001, http://www.ssc.wisc.edu/irp/pubs/dp122701.pdf.

[28] Ibid.

[29] Many employees, especially low-wage earners, start receiving benefits at an earlier age, in which case Social Security payments replace an even smaller portion of prior earnings. Low earnings are defined as average earnings over the course of a career that are equal to about 45 percent of the Social Security average wage index; in 2004, this would have meant average earnings of approximately $15,776. See *The 2004 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors' Insurance and Disability Insurance Trust Funds*, March 2004, tables V.C1 and VI.F11, available at http://www.ssa.gov/OACT/TR/TR04/tr04.pdf.

[30] Many financial planners suggest that a comfortable standard of living during retirement requires income equal to about 70 percent of preretirement income. This required "replacement rate" is less than 100 percent for various reasons, including that work-related expenses are eliminated and retirees often have time to shop for lower-priced goods and services.

[31] Legal immigrants face more restrictive food stamp eligibility rules than citizens. Some states provide state-funded food assistance to certain categories of legal immigrants who are ineligible for food stamps. In addition, eligibility for unemployed adults who do not have children is limited to three months out of a three-year period in many parts of the country.

[32] Under the Food Stamp Program, a household is generally defined as a group of people who live together and buy food and prepare meals together.

[33] See 7 C.F.R. §273.8. In the Food Stamp Program the asset test is also known as the resource test.

[34] See 7 U.S.C. §2014(g).

[35] See 7 C.F.R. §273.8(c).

[36] See 7 C.F.R. §273.8(e).

[37] See 7 C.F.R. §273.2(j)(2)(i).

[38] Under rules that USDA's Food and Nutrition Service published on November 21, 2000, individual recipients of any type of TANF-funded services are considered recipients of TANF "benefits" for purposes of this provision of the law. See 7 C.F.R. §273.8(e)(17). For a more detailed discussion of these rules, see *New State Options to Improve the Food Stamp Vehicle Rule*, David Super and Stacy Dean, Center on Budget and Policy Priorities, January 2001, pp. 9–11, available at http://www.cbpp.org/1-16-01fs.pdf. Also, see note 52.

[39] For more information on how to implement this option, see *Implementing New Changes to the Food Stamp Program: A Provision by Provision Analysis of the Farm Bill*, Stacy Dean and Dorothy Rosenbaum, Center on Budget and Policy Priorities, revised in January 2003, available at http://www.cbpp.org/8-27-02fa.htm.

[40] This explanation of food stamp vehicle asset rules has been simplified for clarity. For a more detailed explanation of the vehicle asset test, see *New State Options to Improve the Food Stamp Vehicle Rule*, David Super and Stacy Dean, Center on Budget and Policy Priorities, January 2001, pp. 6–7, available at http://www.cbpp.org/1-16-01fs.pdf.

[41] Under the federal rules, not all vehicles are counted toward the vehicle asset limit. A vehicle is not counted, for example, if the household has less than $1,500 equity in it, if the vehicle is used primarily for income-producing purposes (such as a taxi cab), or if the vehicle is needed for long-distance, employment-related travel (other than daily commuting) or to transport a physically handicapped household member.

[42] For a description of each state's vehicle asset policy, see *States' Vehicle Asset Policies in the Food Stamp Program*, Center on Budget and Policy Priorities, revised February 2005, available at http://www.cbpp.org/7-30-01fa.htm.

[43] See 7 C.F.R. §273.8(e)(2). FNS clarifying policy on the exclusion of certain retirement plans can be found at http://www.fns.usda.gov/fsp/rules/Memo/02/pensions.htm.

[44] The exclusion of these retirement accounts was established through USDA policy guidance (see note 43) and is not included in the program's regulations. There is a chance that some states or localities are not aware of the policy guidance and mistakenly count savings in such retirement accounts.

[45] See 7 U.S.C. §2014(g)(6). USDA guidance on this option is in *Questions and Answers Regarding the Food Stamp Program (FSP) Certification Provisions of the Farm Bill*, available at http://www.fns.usda.gov/fsp/rules/Legislation/2002_farm_bill/farmbill-QAs.htm.

[46] 7 U.S.C. §2014(g)(6).

[47] *Questions and Answers Regarding the Food Stamp Program (FSP) Certification Provisions of the Farm Bill*, Question 4107-5, available at http://www.fns.usda.gov/fsp/rules/Legislation/2002_farm_bill/farmbill-QAs.htm.

[48] Similarly, so long as a state excludes funds in SEP-IRAs or Keogh plans that involve no contractual obligation with anyone who is not a household member from its TANF or Medicaid asset test, it may exclude them from the food stamp asset test.

[49] More detail on states that have conformed food stamp income and resource rules to TANF and Medicaid rules is available at http://www.fns.usda.gov/fsp/rules/Legislation/2002_farm_bill/ conformance_options.htm.

[50] See 7 U.S.C. §2014(d).

[51] Until final regulations are published, states can disregard all retirement accounts, including IRAs if they disregard IRAs in the asset tests used in their TANF cash assistance or family Medicaid programs. See USDA's guidance on how the new provision may be implemented until final regulations are issued at http://www.fns.usda.gov/fsp/rules/Legislation/2002_farm_bill/fy02_resource_issues.htm

[52] References to "TANF" funds or programs include maintenance-of-effort funds or programs.

[53] In fiscal year 2003, states devoted 35 percent of total TANF and MOE funds used that year to providing cash assistance. Center on Budget and Policy Priorities calculations using state TANF and MOE spending data reported to the U.S. Department of Health and Human services, which is available at http://www.acf.dhhs.gov/programs/ofs/data/index.html.

[54] An exception to the broad flexibility that states generally have to establish TANF eligibility rules is that federal law bars states from using federal TANF dollars to assist most legal immigrants who entered the country after August 22, 1996 (the date the welfare law was signed), until they have been in the United States for at least five years. This restriction applies not only to cash assistance but also to TANF-funded work supports and services such as child care and transportation. States can use state MOE funds to provide benefits to recent immigrants; fewer than half do so.

[55] For a list of each state's TANF cash assistance asset limit and vehicle rules, see *Temporary Assistance for Needy Families (TANF) Sixth Annual Report to Congress*, U.S. Department of Health and Human Services, November 2004, chapter 12, table 12:6, available at http://www.acf.hhs.gov/programs/ofa/annualreport6/ar6index.htm. For more information on Virginia's TANF cash assistance policy see Virginia Department of Social Services' *TANF Policy and Manuals*, Section 303 available at http://www.dss.state.va.us/policymanual/tanf/300.pdf. Some states exclude certain assets held by children, such as certain types of education savings accounts. For more information on the treatment of children's assets, see the Urban Institute's Welfare Rules Database at http://anfdata.urban.org/WRD/WRDWelcome.CFM.

[56] These states calculate the value of vehicle using either the equity value or the fair market value, at state discretion. See *Temporary Assistance for Needy Families (TANF) Sixth Annual Report to Congress*, U.S. Department of Health and Human Services, November 2004, chapter 12, table 12:6, available at http://www.acf.hhs.gov/programs/ofa/annualreport6/ar6index.htm.

[57] A link to each state's TANF plan is available at http://www.financeprojectinfo.org/win/tanf.asp and links to policy manuals for some states are included in *Online Information about Key Low-Income Benefit Programs—Links to Policy Manuals, Descriptive Information, and Applications for State Food Stamp, TANF, Child Care, Medicaid, and SCHIP Programs*, Sharon Parrott, Center on Budget and Policy Priorities, updated November 29, 2004, available at http://www.cbpp.org/1-14-04tanf.pdf.

[58] In 2002, nine states—Hawaii, Idaho, Iowa, Kansas, Kentucky, Montana, Nebraska, New Hampshire, and South Dakota—excluded some or all interest income. See the Urban Institute's Welfare Rules Database at http://anfdata.urban.org/WRD/WRDWelcome.CFM.

[59] See enrollment data reported by each state through the Medicaid Statistical Information System, available at http://www.cms.hhs.gov/medicaid/msis/mstats.asp.

[60] As an alternative to covering all SSI recipients, states are permitted to cover only those SSI recipients who meet the income and asset tests that were in place in 1972 when SSI was enacted. States that take up this option are known as 209(b) states. In 2001, there were eleven such 209(b) states: Connecticut, Hawaii, Illinois, Indiana, Minnesota, Missouri, New Hampshire, North Dakota, Ohio, Oklahoma, and Virginia. The asset limits in these states are generally lower than the SSI asset limit of $2,000 for an individual and $3,000 for a couple. (The SSI asset test is discussed in more detail in the following section, and a list of each state's asset limit appears in appendix B.) See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, available at http://research.aarp.org/health/2003_14_abd.html.

[61] The coverage category for this last group of individuals is known as the "medically needy" category.

[62] In other words, an SCHIP-funded Medicaid expansion is treated as a Medicaid expansion and the state's Medicaid eligibility rules for children (including asset policies) apply.

[63] See Social Security Act §1902(r)(2)(A). Asset limits in Medicaid are also referred to as resource standards.

[64] SSI rules limit assets to no more than $2,000 for individuals and $3,000 for couples.

[65] Asset limits for certain categories of Medicaid eligibility coverage for elderly, blind, or disabled individuals appear in appendix B.

66 See Social Security Act §1902(l)(3)(A).

67 The only states that continue to use an asset test for children in determining Medicaid eligibility are Colorado, Idaho, Montana, Texas, and Utah. See *Beneath the Surface: Barriers Threaten to Slow Progress on Expanding Health Coverage of Children and Families*, Donna Cohen Ross and Laura Cox, Center on Budget and Policy Priorities for the Kaiser Commission on Medicaid and the Uninsured, October 2004, table 5, available at http://www.kff.org/medicaid/7191.cfm.

68 Some additional states have eliminated the asset test in their "medically needy" programs. Under these programs, states can elect to cover individuals whose income is above the state's regular Medicaid income limit, but who fall below their state's "medically needy" income limit after their out-of-pocket health-care costs are deducted.

69 Asset policies for other groups of beneficiaries and details regarding what counts as an asset can be found by examining a state's Medicaid plan, which can be found on the website for HHS's Centers for Medicare and Medicaid Services at http://www.cms.hhs.gov/medicaid/stateplans/.

70 See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, table 7, available at http://research.aarp.org/health/2003_14_abd.html and the National Association of State Medicaid Directors' *Aged, Blind, and Disabled Medicaid Eligibility Survey*, available at http://www.nasmd.org/eligibility/results6.asp.

71 See *Medicaid Eligibility Policy for Aged, Blind, and Disabled Beneficiaries*, by Brian Bruen, Joshua Wiener, and Seema Thomas of the Urban Institute for the AARP Public Policy Institute, November, 2003, pp. 31–34, available at http://research.aarp.org/health/2003_14_abd.html.

72 See appendix A for each state's treatment of vehicles in its family Medicaid program.

73 These states are Arizona, California, New Jersey, Rhode Island, and Wisconsin.

74 See Social Security Act §2102(b)(1)(A).

75 Each state's Medicaid plan can be found and searched on the website for HHS's Centers for Medicare and Medicaid Services at http://www.cms.hhs.gov/medicaid/stateplans/.

76 See V. Smith et al., *Eliminating the Medicaid Asset Test for Families: A Review of State Experiences*, Kaiser Commission on Medicaid and the Uninsured, April 2001, available at http://www.kff.org/medicaid/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=13750.

77 This will not necessarily be the case in the eleven "section 209(b) states." See note 60 and the box on page 31.

78 For example, a person with a disability could be ineligible for SSI because he or she receives a Social Security disability insurance benefit that places the person slightly above the SSI income limit, even though the person still falls below the poverty line. Or, the Social Security disability benefit could result in the person having gross income that is modestly above the poverty line, but the individual's disposable income could fall below the poverty line because of large medical expenses that the person incurs. In a number of states, such people may be eligible for Medicaid.

79 The eighteen states are Arizona, California, Connecticut, Indiana, Iowa, Louisiana, Kansas, Michigan, Minnesota, Missouri, New Jersey, New Mexico, Oregon, Utah, Vermont, Washington, West Virginia, and Wisconsin. In Vermont, only retirement accounts based on earnings after January 1, 2000, are excluded. In West Virginia, only retirement accounts initiated after enrollment in the Buy-In are excluded. Washington has no asset test in its Buy-In Program. See Allen Jensen, *State Medicaid Buy-In Program Design Features*, Work Incentives Project, George Washington University, September 4, 2003, draft, available on the web at http://www.uiowa.edu/~lhpdc/work/III_Framework/2003_MedBuyInProgramDesc.doc.

80 See section 1601 et seq. of the Social Security Act, 42 U.S.C. §1381 et seq.

81 See *Annual Report of the Supplemental Security Income Program, 2004* (hereafter, *2004 SSI Annual Report*), p. 2, available at http://www.ssa.gov/OACT/SSIR/SSI04/.

82 See *SSI Annual Statistical Report, 2003*, table 3, Social Security Administration, available at http://www.ssa.gov/policy/docs/statcomps/ssi_asr/2003/index.html.

83 See *2004 SSI Annual Report*, p. 2.

[84] The first $20 of unearned income—for example, from a monthly Social Security benefit—is not counted. See §1612(b)(2)(A) of the Social Security Act, 42 U.S.C. §1382a(b)(2)(A). In addition, $65 of earned income per month plus half of any remaining earnings is not counted. See 20 C.F.R. §1382a(b)(2)(A). "Generally, if the item received cannot be used as, or to obtain, food, clothing or shelter, it will not be considered as income." *2004 SSI Annual Report*, pp. 12–13.

[85] There are eleven states that have Medicaid rules that may be more restrictive than the SSI rules. In these states, receipt of SSI does not mean automatic eligibility for Medicaid. These states are known as "section 209(b) states." For a list of these states, see note 60.

[86] Some states provide supplements only to certain subpopulations of SSI recipients. The Social Security Administration's publication, *State Assistance Programs for SSI Recipients, January 2004*, SSA Pub. No. 13-11975, April 2005, http://www.socialsecurity.gov/policy/docs/progdesc/ssi_st_asst/2004/index.html, provides information about the features of the various state programs. See also, *2004 SSI Annual Report*, table III.H.1, p. 26.

[87] See 20 C.F.R. §416.1205(c). There are circumstances under which SSA will allow a person to receive SSI on a conditional basis while the person is addressing a problem related to an asset. For example, conditional SSI payments may be made to a person who has assets that exceed the program's asset limit if some of the assets in question are nonliquid and it will take time for the person to convert them to cash. Specifically, an individual may receive conditional SSI payments if his or her countable *liquid* assets do not exceed an amount equal to three times the maximum monthly SSI benefit level and the individual agrees in writing to convert the excess nonliquid assets within nine months for real property and within three months for personal property. The individual also must agree to repay SSA the amount received in SSI benefits during the period that the individual's assets exceeded the limit. See SSA POMS §01150.200.B.1; 20 C.F.R. §416.1240; see also section 1613(b)(1) of the Social Security Act, 42 U.S.C. §1382b(b)(1).

[88] In this report, the terms "assets" and "resources" are used interchangeably. It should be noted that the Social Security Administration defines the terms differently. If an individual owns something and has access to it, it is a "resource" for SSI purposes. If the person does not have access to the item, it is an "asset." Because other public benefit programs generally do not make this distinction, it is not used in this discussion.

[89] SSA has recently modified its rules on the treatment of a vehicle and personal effects. Previously, if a vehicle was not excluded from the SSI asset limit (because it was not needed for employment or to obtain medical care, and it had not been modified to transport a person with a disability), $4,500 of the market value of one vehicle was excluded from countable assets. The value of such a vehicle in excess of $4,500 would count against the asset limit, as would the full value of any additional vehicles. See 20 C.F.R. §416.1218. In February 2005, however, SSA changed the rule effectively to exclude one vehicle entirely. See 70 Fed. Reg. 6340 (February 7, 2005). In the same rule, SSA also indicated that it will no longer count clothing that an SSI applicant or recipient receives as income, and it is removing the $2,000 cap on the value of household goods and personal items that it excludes as a resource. Henceforth, all household goods and personal items that do not have investment value will be excluded. See 20 C.F.R. §§416.1102 and 416.1216. These rules took effect on March 9, 2005.

[90] A money purchase plan is a particular type of defined contribution plan, under which employers commit themselves to make an employer contribution determined by a fixed formula, typically as a percentage of each employee's pay. These plans typically do not involve contributions from employees. Money purchase plans are subject to some of the same rules as defined benefit plans, notably the prohibition on withdrawals while a worker continues to be employed by the firm that sponsors the plan and the use of lifetime annuities as the default form of payment. Operation of money purchase plans by employers is now declining.

[91] In the majority of cases, once an individual has begun receiving periodic payments, the lump-sum withdrawal option is not available. However, in the rare case in which the individual has the option to make a lump-sum withdrawal of the rest of the annuity payments while receiving the payments, the amount of the lump sum or the present value of the periodic payments would count as a resource. Communication with SSA, February 15, 2005.

[92] See SSA POMS §SI 01120.210.E.1; §SI 00510.001.D.4.

[93] This has the effect of forcing the person to liquidate the resources. Rather than spending the proceeds, it also is possible for the individual to convert some or all of the proceeds into excluded resources or to use the funds to purchase future services. For example, the person could use a portion of the funds to purchase a burial plot or to set aside up to $1,500 in a special account usable only for burial expenses. SSA does not count a burial plot or a separate burial expenses fund of up to $1,500 as a resource in SSI. See 20 C.F.R. §416.1231. The person also could use the proceeds from a retirement fund to repair his or her home; a home is excluded as a resource. Purchase of an item of household goods, such as a refrigerator or water heater, also would be excluded. See 20 C.F.R. §416.1216. Sometimes, a person may use a lump-sum payment to prepay a number of months of utility bills. The net result of any of these steps, however, is that the person will not be able to retain the funds in a way that would help the person over the course of retirement.

[94] See SSA POMS §SI 01120.210.B. While there are penalties for liquidating most retirement accounts prior to retirement, it seems unlikely that SSI applicants or recipients would be subject to such penalties. Under the tax code, a person can liquidate a retirement account prior to age 59 1/2 without penalty if the person is disabled. The definition of disability for this purpose is similar to the SSI definition of disability. The IRS rule provides that "[y]ou are considered disabled if you can furnish proof that you cannot do substantial gainful activity because of your physical or mental condition. A physician must determine that your condition can be expected to result in death or be of long, continued, and indefinite duration" (IRS Publication 590, available at http://www.irs.gov/publications/p590/ch01.html#d0e7872). SSA will find a person disabled for SSI purposes "if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months" (Social Security Act §1614(a)(3)(A) (42 U.S.C. §1382c(a)(3)(A)). As a result, individuals who are eligible for SSI based on disability generally should not be subjected to a penalty for early withdrawal of funds from a retirement account.

[95] See SSA POMS §SI 00510.001.D.4.

[96] In the rare case in which the individual who has begun to receive lifetime annuity payments can convert to a lump-sum payment, the present value of the periodic payments would count as a resource. Such a circumstance would be extremely unusual.

[97] See SSA POMS §SI 00830.160.B.1.

[98] See discussion of who may make early withdrawals from 401(k) plans on p. 6-7.

[99] See POMS §SI 01120.210.B "A previously unavailable retirement fund . . . is subject to resources counting rules in the month following the month in which it first becomes available." If the employer's rules provide a window of time during which the former employee can remove the funds and the former employee fails to act during that period, resulting in the funds being retained in an employer's account until some later date, SSA will not count the funds as an available resource during the time that the person cannot access the account. Referring to a similar situation, see POMS §SI 00510.001.E.1: "If the other benefit is no longer available, establish or reestablish eligibility beginning with the month following the month the other benefit is no longer available. The reasons for unavailability may include a *limited time period for filing which has expired* or withdrawal of a lump-sum payment from a pension fund" (emphasis added).

[100] See *2004 SSI Annual Report*, table V.E1, p. 94.

[101] The ineligible spouse's or parent's countable assets are deemed to the SSI applicant or recipient and counted as if they are the SSI applicant's or recipient's. See the provision on spousal deeming, Social Security Act §1614(f)(1) (42 U.S.C. §1382c(f)(1)), and the provision on parental deeming, Social Security Act §1614(f)(2)(A) (42 U.S.C. §1382c(f)(2)(A)).

[102] Ibid. The statute requires deeming to occur "whether or not available to such individual [the SSI applicant or recipient], except to the extent determined by the Commissioner of Social Security to be inequitable under the circumstances."

[103] See 20 C.F.R. §§416.1202(a) and (b)(1). The policy with regard to pension funds of ineligible spouses and ineligible parents took effect on September 1, 1987. Before that, these funds were counted as a resource. See POMS §SI 01330.120.A.1.b and §SI 01330.220.A.I.b.

[104] 52 Fed. Reg. 29840 (August 12, 1987). "We believe it is inequitable to jeopardize the future of a person whose resources are deemed so that another individual's current needs can be met. This requirement is especially burdensome because deeming is often a temporary situation which ceases, for example, when a child reaches age 18 or a couple no longer lives together in the same household. In order to be supportive of families, we believe it is preferable to permit a spouse or parent to provide for his or her own future while recognizing the current needs of the otherwise eligible individual. Therefore, we will not count pension funds owned by an ineligible spouse, ineligible parent or ineligible spouse of a parent. We will continue our policy of counting the equity value of these funds (including any interest accrued) as an available resource to an applicant or recipient who is the owner of a pension fund. . . . It is fair and correct to count the pension funds of an applicant/recipient because SSI is a current needs-based program. Consequently, the individual's own current needs must outweigh his or her future needs."

[105] Section 1611(e)(2) of the Social Security Act provides that a person will not be eligible to receive SSI if SSA has notified the person that he or she may be eligible for “any payment of the type enumerated in section 1612(a)(2)(B)” and the person fails to apply for and obtain the payments (Social Security Act §1611(e)(2), 42 U.S.C. §1382(e)(2)). See also, 20 C.F.R. §416.20(a). Section 1612(a)(2)(B) of the Social Security Act refers to the following types of payments: “(B) any payments received as an annuity, pension, retirement, or disability benefit, including veterans’ compensation and pensions, workmen’s compensation payments, old-age, survivors, and disability insurance benefits, railroad retirement annuities and pensions, and unemployment insurance benefits,” Social Security Act §1612(a)(2)(B) (42 U.S.C.§1382a(a)(2)(B)), and similar language in 20 C.F.R.§416.210(b). The focus here is on securing ongoing payments that can help to reduce or eliminate the need for SSI on an ongoing basis. Receipt of a lump-sum payment does not meet this need and, in fact, frustrates the possibility that the person will later have an ongoing payment that could reduce the need for SSI.

[106] For more information about the president’s New Freedom Initiative, see http://www.whitehouse.gov/news/freedominitiative/freedominitiative.html and http://www.whitehouse.gov/infocus/newfreedom/; see also http://www.ssa.gov/pressoffice/disabilityinfo-pr.htm.

[107] The eighteen states are Arizona, California, Connecticut, Indiana, Iowa, Louisiana, Kansas, Michigan, Minnesota, Missouri, New Jersey, New Mexico, Oregon, Utah, Vermont, Washington, West Virginia, and Wisconsin. In Vermont, only retirement accounts based on earnings after January 1, 2000, are excluded. In West Virginia, only retirement accounts initiated after enrollment in the Buy-In are excluded. Washington has no asset test in its Buy-In Program. See Allen Jensen, *State Medicaid Buy-In Program Design Features*, Work Incentives Project, George Washington University, September 4, 2003, draft, available on the web at http://www.uiowa.edu/~lhpdc/work/III_Framework/2003_MedBuyInProgramDesc.doc.

[108] See note 99.

[109] Not all retirement accounts fall into the two categories that SSA generally uses: (1) those in which the person must liquidate the account because no periodic payment is immediately available, and (2) those in which the person can receive an immediate regular payment from the account or from an annuity financed with funds in the account. For example, a person could have a plan that allows the person to take a lump sum or to leave the funds in place but take a payment for a fixed period of time, with the period of time and the payment amounts determined by the individual (within the constraints posed by the amount of funds available in the account). Normally, when a person has such discretion over the use of the funds, as in a savings account, SSA will count the full amount as being available to the person. Doing so here, however, would have the same effect as requiring the person to liquidate the account by taking a lump-sum payment because, either way, the person will be ineligible for SSI for as long as the amount available exceeds SSI’s countable resource level ($2,000), when combined with other countable resources the person may have. The person thus must liquidate the account to establish SSI eligibility, with the result that no retirement funds will be available to help support the individual in old age. We recommend that when accounts such as this exist, SSA should use the approach described here: SSA should provide that an individual with a disability will not be required to liquidate an account—in other words, the account will not be counted as a resource—until the individual reaches age 65. At that point, the procedures proposed here for treatment of retirement accounts for those age 65 or older would apply.

[110] For example, a person who is age 55 and has a disability may meet the disability test for both SSI and Social Security Disability Insurance benefits—which use the same test—but not have sufficient quarters of recent work to meet the “recency of work” test required to receive Disability Insurance benefits. However, he or she may have sufficient quarters of coverage to be eligible for retirement benefits when he or she reaches retirement age. (There is no recency of work test for retirement benefits.) Assuming that the person is otherwise eligible for SSI, this person will begin receiving SSI benefits at age 55. However, when the person becomes age 62, the first time that a person can receive a Social Security retirement benefit, SSA will require the person to apply for the retirement benefit, even though this will result in the person receiving an actuarially reduced Social Security retirement benefit for life. The current statutory provision requires this.

[111] It would be important for SSA to help SSI recipients understand how this worked, so recipients would know they could take such an amount from their accounts each month.

[112] See H.R. 1776, §311, introduced in the 108th Congress on April 11, 2003. Co-sponsors with Reps. Portman and Cardin on the original bill included Rep. Nancy Johnson (R-CT); Rep. Roy Blunt (R-MO); Rep. Fred Upton (R-MI); Rep. Elton Gallegly (R-CA); Rep. Earl Pomeroy (D-ND); Rep. Dennis Moore (D-KS); Rep. Ellen Tauscher (D-CA); and Rep. Albert Wynn (D-MD). Under the legislation, recipients would be notified at age 59½ that a monthly annuity value would be computed, and start being counted as income, in one year. The one-year grace period was intended to allow recipients time to determine whether to actually convert the account to an annuity.

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