# Optimum Long-Term-Care Planning

## This type of planning makes long-term-care protection more affordable for many clients.

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The professional community consisting of financial and tax advisors must work together to develop strategies to make long-term-care (LTC) protection *more affordable* for clients who plan to live into their 80s, 90s and beyond. Taking this important step will help solve the upcoming and inevitable long-term-care crisis.

For a healthy 61-year old male, about $4,000 per year can purchase $250 worth of daily coverage (or $90,000 a year, in today's dollars), with a 5-year benefit duration, and a 3% compound inflation feature. At age 90, the total five-year available tax-free long-term-care benefit would exceed $1,000,000. What is more, the policy would include all of the benefits of a "partnership program" policy. Now let's analyze the significant benefits this plan affords.

First, the $4,000 premium is tax deductible, either fully, for a self-employed individual or a C corporation, or as an itemized deduction, otherwise.[1] At just a 25% federal marginal income tax bracket, and ignoring potential state income tax benefits, the after-tax cost to the individual is just $3,000 a year for over $1 million of potential income tax-free long-term care coverage, spread out over five years (or over $200,000 a year, with the compound inflation feature), at age 90. Although of course premium rates could rise again in the future, these insurance benefits alone are nevertheless evident. $3,000 a year for over $1 million of income-tax-free long-term care protection at age 90 sounds pretty good.

Second, because this plan involves a partnership program policy, this means that if $1 million of insurance protection is afforded under the policy, a like $1 million of the insured's assets will not be considered a resource for Medicaid-qualifying purposes, should the insured outlive the policy's coverage. This principal aspect of the partnership program provides a singular benefit that planning with hybrid life insurance/LTC policies cannot achieve, because it allows an individual with, for example, a $1 million IRA, the ability to forego having to liquidate the IRA and pay significant income taxes, in order to transfer the net amount to his or her children in an effort to qualify for Medicaid if the insured should outlive the policy's coverage.

Finally, remember that the benefits paid under any long-term-care insurance policy (partnership program or not, and whether in the traditional form or under a hybrid life insurance-LTC policy) are received by the insured income tax-free. This hugely beneficial feature of long-term care insurance will become even more significant if Congress eliminates the medical expense deduction, and thereby also eliminates the deduction for the current annual average $90,000 cost of long-term care not paid for with insurance.

## Using Medicaid planning alone

Medicaid planning typically involves an individual making a decision to transfer the individual's assets away to his or her children with the hope that long-term care will not be needed for at least five years, and therefore the individual will qualify for Medicaid to pay the cost of his or her long-term care, at that time. This so-called "5-year planning" carries with it three primary issues for the planner.

First, what is the best age to advise the individual to transfer all of his or her assets to the children? 70? 75? 80? 85? The dilemma is obvious. Transfer the assets away too soon, and the client must live for a long period in total reliance on his or her children. Transfer the assets away too late, and risk not satisfying the five-year waiting period.

Just as importantly, if we assume that a principal asset of most retired individuals is their IRA, the only way to transfer the same is by cashing it and transferring the after-tax proceeds to the children. Accelerating income taxes is obviously not something most individuals will want to do, especially when considering the significantly higher income tax bracket this is likely to place them in.

Finally, most individuals will prefer in-home care to institutional care, for as long as possible. Relying exclusively on 5-year planning, without an insurance element, obviously seriously limits the individual's options in this regard.[2]

## The optimum plan

The optimum long-term-care plan solves all of the issues associated with 5-year planning alone by combining the benefits of a long-term-care partnership plan, 5-year planning, and sound tax planning. Here is how it works:

By purchasing a traditional partnership program LTC policy designed to provide five years' worth of protection, the individual does not need to consider transferring assets to his or her children until he or she actually needs long-term care. At this point most individuals are more willing to make the transfers, since their need for the assets diminishes. They can even transfer their home to their children and still retain the right to live there, since this retained right does not constitute a resource or income available to the individuals for Medicaid-qualifying purposes.

Most important is the fact that, based on the above set of facts, and utilizing a partnership program plan LTC insurance policy, the individual is able to retain an IRA valued at $1 million or more, without having to liquidate the same and pay substantial income taxes. What a huge tax benefit to the individual and his or her family, over traditional 5-year planning! The individual may then also be able to utilize the IRA or other assets to help supplement what Medicaid pays, e.g., to pay the additional cost for a private room versus a semi-private room.

Once the assets other than the IRA are transferred, the five-year clock begins ticking. After five years of long-term care provided for by the LTC insurance/partnership program policy (all or a portion of which can be in the home), the situation for most individuals will be more amenable to institutional care; so, they can then apply for Medicaid. There is no need to purchase a policy that includes a benefit payable beyond five years, which will result in a significant cost saving for the individual and his or her family.

*The individual has now essentially achieved full long-term-care protection, for life, for the cost of the annual premium on a traditional, partnership program LTC insurance policy paying out a five-year benefit at the estimated full future cost of care, all while retaining his or her IRA and the right to live in his or her home.*

## Using hybrid long-term-care plans

Although not tax deductible, the newer forms of hybrid, LTC/life insurance policies assure the client and his or her family an aggregate life and/or LTC benefit at least equal to the premiums expended. The insured and/or his or her family is guaranteed the benefit designated in the policy, regardless of whether long-term care is ever needed. Hybrid policies are therefore said to provide more flexibility than traditional "stand alone" LTC insurance policies, because the insured's premium dollars are not potentially wasted.

However, for the same (oftentimes tax deductible) premium dollar, a traditional partnership program LTC insurance policy will purchase *substantially* more long-term care insurance protection, and will include all of the above-described tax and Medicaid planning benefits associated with the partnership program. Put another way, a substantially lower premium (as compared to a hybrid policy) will purchase a like amount of long-term-care protection under a traditional partnership program LTC policy (and oftentimes on a tax-deductible basis), with the added tax and Medicaid planning benefits afforded under a partnership program policy.

When the coverage period of a hybrid policy runs its course, there is no Medicaid resource protection for the individual, as there is with a partnership program policy. In order for the individual to qualify for Medicaid benefits at that time, the individual would have had to transfer all of his or her assets away, five years earlier, and would have had to liquidate his or her entire IRA and pay substantial income taxes on the same. Especially when

viewed in this tax-disadvantaged light, the financial risk of opting for a hybrid type LTC insurance policy over a traditional, partnership program LTC insurance policy becomes significant.

## It's the client's choice

Although on balance it can be argued that the benefits of optimum long-term-care planning outweigh the benefits of utilizing the newer forms of hybrid long-term- care/life insurance policies, it is ultimately the client's decision to make. For example, in a particular client's family history it may be rare that a family member has ever needed any significant long-term care, thus causing the client to understandably favor a hybrid policy over the traditional form of long-term-care protection.

The client may also understandably fear that future potential premium increases under a traditional LTC insurance policy outweigh all of the benefits of optimum long-term-care planning outlined in this article. Finally, it may be easier to qualify for a hybrid policy versus a traditional long-term-care policy. All of these factors are definitely relevant considerations.

The advisor's role is merely to outline, in clear and plain terms, the pros and cons of optimum long-term-care planning utilizing a partnership program policy versus planning utilizing the newer forms of hybrid policies. The ultimate goal of each approach is the same: As outlined at the outset of this article, make long-term-care protection more affordable for the client, in order to help solve the upcoming and inevitable long-term-care crisis. at

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1 Remember that although an individual may not be able to make full use of a long-term care itemized deduction during his or her working years, during retirement the individual is much more likely to satisfy the 10% threshold for medical expense deductions, through a combination of lower income teamed with the increased costs associated with supplemental medical insurance premiums and out of pocket medical expenses. Note also that the premium deduction limitation is lower for individuals who are under age 61, and higher for individuals who are over age 70. Full or partial tax deductions utilizing a health savings account may also be available. Finally, remember that Congress may eventually choose to eliminate the medical expense deduction altogether and/or raise the standard deduction to a level where these deductions become moot for many itemizers.

2 Note that another potential concern is that the transfers will constitute taxable gifts for federal gift tax purposes, but with a lifetime gift tax exemption of $5.5 million today, this will not be an issue for most individuals.