AICPA Store Brought to you by CPA2Biz

PRINT THIS PAGE

Igor Zey

Help Your Clients Plan for Long-Term Care Now

Here's how.
August 19, 2010
by Igor Zey, MSFS, ChFC

In last month's article, I divulged the rising costs and the increasing probability of long-term care needs. Once you or your clients have had a chance to evaluate your needs and resources, the following questions may arise:

- What are the different options for purchasing long-term care insurance?
- What will it cost?
- Are there tax advantages to different avenues of protection and what are they?

It is wise to plan for long-term care when your clients are still active and healthy, because this care is often very expensive and is not covered by private medical insurance or Medicare.

Obtaining Long-Term-Care Insurance

There are numerous 'standalone' long-term-care policies available for purchase from a number of highly rated insurance companies. Standalone policies come with various options, such as benefit levels, services and eligibility requirements, all of which affect the cost of the policy.

Another avenue for obtaining long-term-care coverage involves annuities and life insurance policies. There are several ways you can use your life insurance policy to help pay for long-term care. These include:

- Accelerated Death Benefits
- Life Settlements
- Viatical Settlements

An Accelerated Death Benefit is a life insurance death benefit paid in cash in advance, tax-free. It is a feature included as a rider with some life insurance policies, and can provide benefits in cases when the insured is terminally ill, has a life-threatening diagnosis, is in need of long-term care for an extended period of time or is permanently confined to a nursing home and is incapable of performing the everyday Activities of Daily Living.

Life Settlements give you the ability to raise cash by selling your life insurance policy for its present value. With a multitude of intricate parameters determining present value of a policy, this is hardly a method to rely on for long-term-care needs, but rather something to consider in absence of other options available.

A practice related to life settlements is Viatical Settlements, which allows the sale of a life insurance policy to a third-party in cases of terminal illness, meaning having a documented life expectancy of two years or less.

Recent Developments in Life Insurance and Annuity Products

Life Insurance Options:

Recognizing a rising need for long-term-care insurance, many carriers have been coming out with new products to address this need and market segment. There has been great

improvement in the availability of dependable and affordable solutions to meet people's long-term care needs.

The "what if I never need long-term care?" concern has been one of the major reasons people don't protect themselves and their loved ones against the potential risk of needing this care and the enormous cost (both financial and emotional on the family and loved ones) that occurs when the care is needed. People have been reluctant to purchase standalone long-term-care policies because they didn't want to pay premiums for a policy that may have never ended up providing a benefit.

A solution for people with this mindset is a *Life-LTC Combination Policy*, which is a permanent life insurance policy with a long-term-care (LTC) rider. Such a policy guarantees that a benefit will be paid, such as a life insurance death benefit, a long-term-care benefit or some combination of the two. When choosing the LTC rider, your clients can use some or none of the death benefit to help pay for LTC expenses. Any portion that is not used will be paid to their heirs, and will be income tax-favored under current law.

These types of policies are available with varying benefit levels, elimination periods and other riders. An important rider to note is a Return of Premium Rider. This option allows for a full refund of the premium deposited at any time. At the time this return of premium is requested, the policy is terminated.

In addition to life insurance underwriting, insurance companies will generally apply very similar health standards as used for traditional long-term-care insurance protection. As a result, it is important that this protection is applied for while you are still in relatively good health. That means applying for coverage after the age of 50 optimizes the cost and available coverage.

Annuity Options:

On the annuity front, new tax benefits have triggered recent product developments not available to annuitants in the past. The Pension Protection Act of 2006 included some key provisions that addressed for the first time the taxation of combination annuity plans featuring long-term-care insurance (LTCI). The rules apply only to nonqualified annuities coupled with tax-qualified LTC riders. The Act clarified that — effective Jan. 1, 2010 — LTCI benefits paid out of these plans (even if a portion of those serves to reduce account values in the underlying annuity) are paid as tax-free LTCI benefits. This is unprecedented in the annuity world. Prior to that date there was no mechanism that allowed for gains in a contract to be paid out on a tax-free basis. In addition, the law also allows for 1035 exchanges into combination plans. This is noteworthy in light of the many trillions of dollars deposited in existing annuities.

Tax Considerations

Tax Deductibility of Premiums:

In general, premiums for "qualified" LTC policies are treated as a medical expense and are deductible to the extent that they — along with other unreimbursed medical expenses — exceed 7.5 percent of the insured's adjusted gross income. To be "qualified," policies must adhere to regulations established by the National Association of Insurance Commissioners. The deductibility of premiums is limited by the age of the taxpayer at the end of the year, as follows (the limits will be adjusted annually with inflation):

Age attained before the end of the taxable year	**Amount allowed as a medical expense in**	
	2009	**2010**
40 or under	$320	$330
41-50	$600	$620
51-60	$1,190	$ 1,230
61-70	$3,180	$ 3,290
71 or older	$3,980	$ 4,110

Deductibility of long-term care premiums paid by companies as a business expense is primarily regulated by the IRC §7702B. Generally, employers will be able to deduct, as a business expense, both the cost of setting up a LTCI plan for their employees, and the contributions that they may make toward paying for the cost of qualified LTCI premiums. However, sole proprietors cannot deduct 100 percent of the premiums paid on behalf of themselves, their spouse or their qualified dependents, but rather are limited to the eligible premiums.

Employer contributions are excluded from the taxable income of employees. Tax-qualified LTCI may not be purchased by an employee through a cafeteria plan.

Premiums may not be paid for using a Flexible Spending Account (FSA), but may be paid for using a Health Spending Account (HSA). According to Health Insurance Portability and Accountability Act (HIPAA) requirements, if your client leaves a company, their LTC coverage is portable, regardless of who was initially paying the premiums.

Taxation of Benefits:

Benefits paid from reimbursement policies, which pay for the actual services a beneficiary receives, are not included in income regardless of who paid the premium. Benefits from per diem or indemnity policies, which pay a predetermined amount each day, are not included in income except amounts that exceed the beneficiary's total qualified LTC expenses or $290 per day (in 2010), whichever is greater.

Provisions of the Pension Protection Act of 2006 (PPA):

As mentioned above, the PPA included provisions affecting qualified LTCI, which became effective January 1, 2010. Some of these provisions are:

- Tax-free 1035 exchanges of life insurance, endowment and annuity contracts for LTCI policies will be allowed.
- Charges from the cash value of an annuity with an LTC rider used to pay for the LTCI coverage will be excludible from the owner's income. However, such charges will reduce the investment in the annuity contract and are not funded using un-taxed annuity gains. This brings the tax treatment of annuity/LTCI contracts in line with the current treatment of non-MEC (modified endowment contract) life/LTCI policies. Prior to January 1, 2010, charges from the annuity cash value to pay for LTCI charges were treated as distributions and were taxable to the extent there was gain in the annuity contract.
- Qualified LTCI benefit payments from a combination life/LTCI or annuity/LTCI contract are tax free (just as they are for stand-alone LTCI contracts).

Guidance on the detail application of some of these provisions is still pending from the Internal Revenue Service (IRS).

Conclusion

With the ever-increasing options available for LTC coverage, it may be wise to consult with a qualified advisor, who would be able to recommend proper products based on an evaluation of the overall financial needs and requirements of the individual or the business.

Rate this article 5 (excellent) to 1 (poor). Send your responses here.

__Igor Zey__, MSFS, CAP, CLU, ChFC, AEP, CFP, is the president of Zey Insurance Group. His practice focuses on uses of life insurance in the areas of estate and charitable planning, family law, wealth transfer in business and retirement. ***Acknowledgments:*** *He acknowledges using material and information in this article that was provided by Milliman, Inc., various insurance carriers, aaltci.org and elderlawanswers.com*

The AICPA's Personal Financial Planning Section is the premier provider of information, tools, advocacy and guidance for CPAs who specialize in providing estate, tax, retirement, risk management and investment planning advice to individuals and closely held entities. The Personal Financial Planning Section is open to all Regular Members, Associate Members and Non-CPA Section Associate Members of the AICPA. If you are a CPA who wants to demonstrate your expertise in this subject matter, become a Personal Financial Specialist Credential holder. Visit www.aicpa.org/PFP to learn more.