

# Have You Incorporated Long-Term Care Solutions into Your Client's Estate Plan?

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*By Ellen V. Springer*

*Ellen Springer explains our obligation to discuss our clients' plans for their long-term care. Without proper planning, the consequences of an extended stay in a long-term care facility can be quite serious for a spouse who may remain living independently and children and estate beneficiaries. Ms. Springer discusses when long-term care insurance is appropriate and suggests that an early approach to this topic will be the most efficient approach.*

## **Introduction**

About five years ago, my closest friend, and client of over 15 years, called me to review long-term care insurance policies for herself and her husband. I have to admit that at that time, I did not understand why they were considering purchasing insurance to cover their long-term care costs, as they had more than \$1 million in assets. Why would they want to throw away money on premiums when it seems that they could afford to pay for their own care without insurance?

As she explained, since they did not have children, she was worried about what would happen to one or both of them if they became disabled or needed care. Who would look after them? Well,

I explained that I would, of course! But they live in Florida and I live in Georgia, and I began to realize that the problem was more complicated than I thought. Although I wanted to look after their needs, I might not be in a position to provide the care they needed. My friend's mother lived to be 100. There is a very real possibility she might outlive me! I had been their CPA for over 15 years and had worked with them to develop both their estate plan and their financial plan for retirement. But we had never discussed what would happen to their assets and their retirement income when one or both of them required extended long-term care. As a professional advisor, I had overlooked this possibility, and not worked with them to develop a "plan" for this eventuality.

## **Aging America**

America is aging as the Baby Boomers, born between 1946 and 1964, are fast approaching retirement age. In 2000, people aged 65 and older made up 12.4 percent of the nation. By 2030, they will surge to 20 percent.<sup>1</sup>

The *U.S. Census Bureau's Population Projections of the United States: 1995-2050* projects that the population aged

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**Ellen V. Springer**, M.B.A., CPA, AEP, CLTC, CSA, RFC, is a Principal, Managing Director and Branch Manager for Investors Capital Corporation. She is also a National Instructor for the CLTC program and teaches finance and insurance courses at Kennesaw State University in the Economics and Finance Department.

65 and older will more than double. The proportion of those 80 and older alone will increase 225 percent. A 1997 Health Insurance Association of America (HIAA) report forecasted that the number of elderly needing long-term care is expected to almost double to 14 million between 1997 and 2030.<sup>2</sup> Americans who reach age 65 face a 40-percent lifetime risk of needing some form of long-term care.<sup>3</sup> According to estimates by the Centers for Medicare & Medicaid Services, two out of every five people in the United States will eventually require some form of long-term care.<sup>4</sup> With this increase, how will the government afford to pay for all of this care? Advances in medical technology may soon turn cancer and heart disease into chronic, rather than terminal, illnesses.

Currently, over 80 percent of long-term care is provided by the community. Family members, adult daycare centers and assisted living facilities, and other community programs provide this care.<sup>5</sup> Sixty-five percent of older persons with long-term care needs rely exclusively on family and friends to provide assistance.<sup>6</sup> Of these informal caregivers, seven out of 10 are women,<sup>7</sup> and 89 percent of them reported increased levels of stress resulting from their new duties.<sup>8</sup>

We are living longer, and with modern technology's diagnostic testing and replacement of body parts, a long life is becoming a reality.

Long-term care costs are expensive and are increasing faster than the rate of inflation. As a national average, a year in a nursing home is estimated to cost as much as \$57,765.<sup>9</sup> These costs can deplete the average person's portfolio quickly.

Most professionals hear time and time again that their clients are afraid to "outlive" their assets. These fears are well-founded. It is the professional advisor's responsibility to educate them on the potential threat that long-term care poses to their assets and help them develop their individual plan.

I became CLTC certified in a long-term care certification program designed by Attorney Harley Gordon. I am now an instructor and speak frequently about long-term care issues. Through my training and experience, I have come to realize that it is our responsibility, as professional advisors, to assist our clients in planning for their long-term care while protecting the assets they need to support themselves in retirement and the inheritance they want to leave for their beneficiaries.

## The Problem

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"Long-term care is a family issue. The question is not whether your family will take care of you, they will because they love you. But is this what you really want your family to do."<sup>10</sup> I will never forget the first time I heard Harley Gordon say this. Besides, even with good intentions, your family may not be able to provide the majority of your care. Unfortunately, one member of the family usually ends up being the caregiver, with the rest of the family failing to share equally in those duties. The caregiver becomes resentful of the other nonparticipating members. This can create friction and destroy family relationships. Additionally, stress from the family and providing care to the ill family member can actually reduce the life expectancy of the caregiver. Most people do not realize how hard it is day in and day out caring for someone in addition to managing your own job and family commitments.

Many times, children are in the sandwich generation where they have children that they are still raising, their parents are getting older, and they are working full-time. It is difficult to provide the necessary daily care for the parent. Therefore, when you work with clients, it is very important to ask them what their plans are for long-term care. It is not a question of whether they will get sick. It is a question of when they will get sick, and whether they have discussed a plan for care with their children. Several definitions are important in discussing long-term care.

"Skilled care," which is often provided in a skilled nursing facility, is care that is administered by a doctor or executed by a skilled nursing staff—someone with training, and a license or certification. Skilled care is traditionally covered by health insurance programs.

"Custodial care" is providing assistance with the activities of daily living, frequently called ADLs. These include toileting, bathing, dressing, eating, transferring and continence. It also includes supervision required by severe cognitive impairment. It is custodial care that we refer to as "long-term" care, and this is not covered by traditional health insurance.

Most families plan for retirement and for their estates at their deaths. They usually formulate an investment strategy with their advisors that will generate income for their retirement including

Social Security benefits, possible pension benefits and investment income to cover the budget that they expect after their retirement. But many times they have not considered the devastation that long-term care costs can cause. Therefore, we need to make sure that those assets are available to do what they were intended to do and that is to provide for retirement.

## Funding Options

The funding options for long-term care include Medicare, Medicaid, the Veteran's Administration, self-funding and long-term care insurance.

Medicare is health insurance, and this federal program pays for skilled care. In most cases, this is skilled care provided in a skilled nursing facility, or nursing home, and not in the patient's home. It will pay for skilled or rehabilitation services in the home only when the patient is continuing to improve from whatever illness or disability caused the impairment. Examples include a speech therapist or rehabilitation therapist providing exercises on very specific parts of the body. But it does not provide for someone to look after the patient on a daily basis and assist him or her with activities of daily living. Medicare usually does not provide for adult daycare or assisted care living. With skilled nursing facilities, it will pay certain percentages for up to 100 days of care per lifetime. Medicare does not provide for custodial care in your home.

Medicaid requires qualification to receive benefits. In order to qualify for Medicaid, you must have minimal assets and not have more than a certain level of household income and meet medical criteria established by the state.<sup>11</sup> Generally, to qualify for Medicaid, you must have less than \$3,000 cash, a paid-up funeral, a home, a car and some personal items. The home may be kept if there is a spouse or special needs child who resides at home. Otherwise, Medicaid can require the house to be sold or a lien be placed on it to reimburse the state for the benefits received. The general rule is that all of the income for the person in the facility must go to the facility, and if it exceeds the actual monthly cost, Medicaid will not pay. If there is a spouse, there are income and asset thresholds set by states that the spouse may be able to keep for their expenses. Many states have a maximum amount of income that can

be earned by the household on a monthly basis to qualify for Medicaid. Although it is a federal program, it is administered by the states, and it is important to understand the rules and applications of your state.

Many elder care advisors advise gifting assets to relatives to qualify for Medicaid. There is a three-year general look back rule and a five-year look back rule when trusts have been set up. If these assets were gifted with the purpose of qualifying for Medicaid, Medicaid has the right to reverse those gifts. As a result, people should be careful with this planning. At the time of applying for Medicaid benefits, a snapshot of assets and income is recorded. If the assets exceed the qualification amount, then they are required to be used to pay for care. The length of time that someone must pay for his own care is usually computed by dividing the countable assets by the average skilled nursing facility cost defined by the state. Medicaid pays for what your client doesn't want—to live in a skilled nursing facility. Your clients want to stay at home and age in place in their community.

There are other pitfalls with gifting certain assets. Gifting amounts held in qualified plans can trigger income taxes to the beneficiary. They no longer have the asset, but have a large tax liability. Gifting of personal residences prevents the capital gains exclusion of up to \$250,000 single and \$500,000 joint in capital gains for owner-occupied residences after a two-year period. This surprises children when they sell their parents' home. In all gifts, the lower of the original cost basis from the original owner or fair market basis at the time of the gift is transferred to the person that receives the gift. It can also cause additional income taxes for the recipient whenever it is sold. Gifts of more than the annual gift tax exclusion should be reported on Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return to the Internal Revenue Service*.

Assets are easier to gift than income. Pension plan payments from former employers are generally not assignable. Payments from trusts are generally not assignable without giving up rights to the trust. Since there is an income qualification as well an asset-value qualification, sometimes clients can give away or spend all of their assets and still not qualify because of the income requirement.

Premarital agreements do not always protect the assets. It is the states that interpret qualifications for

Medicaid, and they review the household income and household assets. Many times, they ignore premarital agreements. If the purpose of the prenuptial agreement was to protect assets so that their individual heirs will receive them, then the couple should consider having long-term care insurance on each other. Divorce and family law attorneys should consider recommending long-term care insurance to their clients after their first marriages.

Those clients who served as veterans believe that the Veterans Administration will pay for their long-term care. The Veterans Administration provides a healthcare program, but the resources are not enough to cover everyone in need. The coverage that is available is rationed based on priority grouping, Veterans Administration funding and the veteran's ability to contribute to the cost. Many veterans find they have to wait prolonged periods of time to receive traditional healthcare benefits. A 1996 General Accounting Office report estimated that the Veterans Administration paid for long-term care benefits for only 34,000 of the 235,000 veterans who needed care.<sup>12</sup>

Self-funding is also an option. Years 2000, 2001 and 2002 in the stock market left many clients with their portfolios cut in half and questioning the ability of the portfolios to provide and sustain for the long-term care that may be needed. With the over-85 demographic group being the fastest growing group in the country, and the expectation that that one in five Americans will be over age 65 by the year 2003, is it realistic to expect that the long-term care cost can be borne by the individual?

## Solutions with Insurance

One of the biggest fears of retirees and seniors is that they will outlive their assets, and one of the ways that they can protect those assets is to consider long-term care insurance. There are a number of policies and riders and coverage options to consider before purchasing a policy. The National Association of Insurance Commissioners (NAIC) has published *A SHOPPER'S GUIDE TO LONG-TERM CARE INSURANCE* to assist states in educating and protecting consumers.

Insurance is a solution for many assets in our lives already. Many states require auto insurance to drive cars on the road, and most people have collision coverage to protect their cars. Most people have homeowners insurance to protect their

homes, many times required by mortgage companies. Many people have life and health insurance to protect their families and their children. Some may have disability insurance to protect the biggest asset they have, which is the ability to earn income during their lifetime. Extra life insurance is sometimes purchased to protect family wealth and provide the liquidity for paying the estate taxes. Purchasing long-term care insurance protects the retirement assets and allows them to do what they were intended to do—provide for retirement.

As we grow older, our bodies age and develop problems. Most long-term care insurance policies require underwriting and qualification for coverage; therefore, it is important for clients to consider purchasing a policy before they incur severe health issues—the younger the better. As a general rule, the long-term care premiums are lower the younger the age purchased. Therefore, consider locking in premiums in your 40s and 50s before health issues become a major concern.

Absenteeism is a concern of employers as employees choose to take leaves of absence to look after their aging parents. Some employers are offering group policies that offer coverage to parents of employees.

Business owners should consider purchasing long-term care policies 10 years before retirement and electing a 10-pay plan and structuring the plan so that it is tax deductible and paid up at time of retirement.

Don't be afraid to discuss long-term care insurance solutions with your wealthy clients, as they realize the benefit of spending pennies to protect dollars. With long-term care costs continuing to increase, how much is enough in assets varies with each person's perspective.

Senior adults who have limited assets and will medically qualify for insurance may have their children pay the premiums to provide for their future long-term care. The premiums don't have to be paid by the insured.

You should *consider* buying long-term care insurance if:

- you have significant assets and income;
- you want to protect some of your assets and income;
- you can pay premiums, including possible premium increases, without financial difficulty;
- you want to stay independent of the support of others; and/or

**Table 1**

Age	Eligible Premium Deduction
less than 40	\$270
40 < 50	\$510
50 < 60	\$1,020
60 < 70	\$2,720
more than 70	\$3,400

- you want to have the flexibility of choosing care in the setting you prefer or will be most comfortable in.<sup>13</sup>

You should *not* buy long-term care insurance if:

- you can't afford the premiums;
- you have limited assets;
- your only source of income is your Social Security benefit or Supplemental Security Income (SSI);
- you often have trouble paying for utilities, food, medicine or other important needs; or
- you are on Medicaid.<sup>14</sup>

## Tax Issues

Long-term care insurance premiums are considered medical expenses subject to limitations on the deduction of the premiums.<sup>15</sup> Only premiums paid for qualified long-term care insurance contracts are deductible. A qualified long-term care insurance contract cannot provide for reimbursement for costs that are payable by Medicare, must be guaranteed renewable and cannot have a medical trigger, cash surrender value or a value that can be paid, pledged or borrowed.<sup>16</sup> The long-term care premium amounts that are deductible for 2005 are based on the age of the person and are shown in Table 1.<sup>17</sup>

When benefits are paid from a qualified long-term care contract, 100 percent of the proceeds on a reimbursement policy are excludible from income. In an indemnity or cash contract, the first \$240 for 2005 or the actual cost of the care is also excludible from income.<sup>18</sup>

The deductions that are available to individuals are different than business owners, and when planning for retirement and estate issues, it is important to consider these differences. It may be important to pay for the long-term care insurance during the working years, maximize the deductions and use before-tax money whenever possible.

If someone purchases a policy individually and does not own a business, then the eligible pre-

mium deduction by age is allowed as a medical deduction. The deduction is recorded on Schedule A as a medical deduction, and all medical deductions must exceed 7.5 percent of adjusted gross income before any amount is included in the total itemized deductions. Then, of course, the total itemized deductions must exceed the standard deduction before any additional tax benefit is realized. Many times, retired taxpayers do not itemize if they are mortgage-free and have minimal medical expenses.

If a husband and wife purchase a joint policy or each have their own policy, they each can claim their eligible premium based on age and may increase their medical deduction.

If a self-employed individual purchases a policy, the eligible premium deduction based on age can be treated as a health insurance premium. Therefore, 100 percent of the eligible premium is deducted on page one of the Form 1040, before the adjusted gross income. Since the eligible premium is not deductible on Schedule C as a business expense, it does not reduce the self-employment taxes due for the business.

If the business owner's spouse is an employee, the company can purchase a policy for him or her, and the total premium is deductible. There is no eligible premium based on age restriction for nonowner employees. Therefore, if the employee-spouse purchased a joint policy, the entire premium would be deductible on Schedule C, allowing a reduction in the self-employment tax. Many insurance companies will write joint policies for domestic partners and couples in committed relationships.

Many families have parents who provide services to their self-employed companies. If an elderly parent provides services to a business and he or she receives compensation as an employee, long-term care premiums paid through the business for this parent-employee would be 100 percent deductible on Schedule C. This would save both income taxes and self-employment taxes on the premiums and no limitation for eligible premium based on age. A 10-pay plan may be considered to pay for the contract using before-tax dollars while the elderly parent is still able to work for the business owner.

The employer pays the premium and receives a deduction against income and self-employment taxes and the employee does not recognize income for the benefit,<sup>19</sup> the best of both worlds.

Employers do not have to cover all employees with the same benefit for long-term care insurance. They can, therefore, discriminate with this benefit.<sup>20</sup> This may provide for employee-family members and for older management employees that seek this benefit at pre-tax dollars.

A self-employed consultant, Sam, age 55, purchased a standard long-term care insurance policy for \$2,000 per year. His eligible deductible premium on page one of the Form 1040 is \$1,020. If Sam's spouse, Peggy, worked for him as an employee, she could purchase a joint policy, and the entire \$2,000 for his portion of her joint policy would be deductible on his Schedule C and would save income taxes on the entire premium and self-employment taxes. A 10-pay option might be considered to pay for policy during working years with pre-tax dollars.

Many taxpayers are learning about health savings accounts to fund their health care costs. These programs require high deductibles of at least \$1,000 for individual coverage and \$2,050 for family coverage with maximum out-of-pocket expenses of \$5,100 for individual coverage and \$10,250 for family coverage.<sup>21</sup>

Business partnerships with greater-than-two-percent partners must reflect the long-term care insurance premiums as guaranteed payments to partners on the Schedule K-1,<sup>22</sup> after deducting on the partnership return.<sup>23</sup> The partner can take the eligible premium deduction based on age on page one of the Form 1040.<sup>24</sup>

A partner, Walt, age 60, has a long-term care policy in the partnership with annual premiums of \$3,500. The partnership deducts the \$3,500 and reports a guaranteed payment to partner on Walt's Schedule K-1 and includes in the self-employed income number the \$3,500. Walt can deduct the eligible premium of \$2,720 on page one of Form 1040. Walt's wife, Sally, is an employee of the partnership, and if the partnership purchased a joint policy in Sally's name, the partnership could deduct 100 percent of the premium. No entry would be reflected under guaranteed payments to partners for this premium. If spouses of partners are employees, the spouses can purchase joint policies and the company can deduct 100 percent of the joint premium as a business deduction. This saves both income taxes and self-employment taxes.

More-than-two-percent shareholders of subchapter S corporations are treated similarly to more-than-two-percent ownership in partnerships. The corporation deducts the long-term care premiums, and the premiums are listed on the Form W-2 as compensation. The shareholder then determines the eligible premium deduction based on age and claims this on page one of the Form 1040. Unfortunately, due to attribution rules, placing a spouse or parent on the payroll does not increase the deduction in subchapter S corporations. All spouses and parents of more-than-two-percent shareholders are limited to eligible premium deductions in the corporation.

**Example.** XYZ Corporation, a subchapter S corporation, has a long-term care policy for Larry, age 50, a more-than-two-percent-shareholder, with annual premiums of \$1,800. The \$1,800 is deducted in the S corporation and then included in Larry's Form W-2 as compensation. Larry can then deduct his eligible premium of \$1,020. Larry's wife, Alice, also works for XYZ Corporation; thus, any policy for her—or even a joint policy—would be limited to eligible premiums based on Alice's and Larry's ages.

Shareholder-employees of C corporations enjoy 100-percent business deductions for 100 percent of their long-term care premiums regardless of percentage ownership in the corporation. Employee-spouses and employee-parents have no limitations on the deduction of their long-term care premiums in the business. If a parent is not an employee, but a tax dependent of the shareholder-employee, these premiums can be deducted as well.

Limited liability companies (LLCs) can be treated several ways depending on the tax treatment of the entity. If it is a single-person LLC, reporting under a Schedule C, the self-employed rules stated above would apply. If the LLC is taxed as a partnership and files a Form 1065, then the partnership rules discussed above for more-than-two-percent partners apply.

Professional corporations (PCs) can also be treated several ways depending on the tax treatment of the entity. If it elects to be treated as a

subchapter S corporation, then the more-than-two-percent rules discussed above apply. If the PC remains a C corporation for tax purposes, the C corporation rules above apply.

## Conclusion

As Americans, we are living longer and have an increasing probability that we will require long-term care at some point in our lives—and it will be expensive. Your clients must have a plan for providing for long-term care and a way to pay for it.

My friends that I discussed earlier reviewed a number of long-term care policies and purchased two policies five years ago. Both of them have experienced health problems in the past year, and they are now uninsurable.

The insurance professional first recognized the need to protect their assets and allow them to age at home when long-term care is required. And second, she encouraged them to purchase the policies at an early age before health issues would prevent insurability. I will be forever grateful to this professional.

As professional advisors, it is our duty to help our clients protect their assets to provide for them in their retirement as well as benefit their families when they are gone. Therefore, it is important to become educated in the long-term care insurance marketplace, and to recognize the need to incorporate long-term care solutions into your clients' estate plans.

## ENDNOTES

- <sup>1</sup> *Wake Up Call*, AARP THE MAGAZINE ONLINE, available at [www.aarpmagazine.org/people/articles/a2004-07-20mag-wakeup.html](http://www.aarpmagazine.org/people/articles/a2004-07-20mag-wakeup.html).
- <sup>2</sup> CERTIFICATION FOR LONG-TERM CARE COURSE HANDBOOK, at 33.
- <sup>3</sup> HEALTH INSURANCE ASSOCIATION OF AMERICA, GUIDE TO LONG-TERM CARE INSURANCE (2002).
- <sup>4</sup> Fitch IBCA, *Long Term Care: An Industry in Transition*, Jan. 18, 2002.
- <sup>5</sup> *Long Term Care: An Overview*, Statement of Carol O'Shaughnessy, Specialist in Social Legislation, Congressional Research Service, Mar. 27, 2001.
- <sup>6</sup> U.S. Administration on Aging, *American's Families Care: A Report on the Needs of American's Family Caregivers*, Fall 2000.
- <sup>7</sup> Statement of William Scanlon, Director Health Care Issues, General Accounting Testimony before U.S. Senate Committee on Finance, 2001.
- <sup>8</sup> Genesis Health Ventures and National Association of Female Executives, Oct. 2002 Poll.
- <sup>9</sup> Met Life Mature Market Institute, *Market Survey of Nursing Home and Home Care Costs*, Aug. 2003.
- <sup>10</sup> Harley Gordon, Attorney at Law, author of HOW TO PROTECT YOUR FAMILY'S LIFE SAVINGS FROM CATASTROPHIC ILLNESS (2001), published by Financial Strategies Press.
- <sup>11</sup> *Supra* note 2, at 120.
- <sup>12</sup> *VA Health Care: Better Data Needed to Effectively Use Limited Nursing Home Resources*, General Accounting Office, HRD-97-27, 1996.
- <sup>13</sup> National Association of Insurance Commissioners, *A Shopper's Guide to Long-Term Care Insurance*, 2003, at 8.
- <sup>14</sup> *Id.*
- <sup>15</sup> Code Sec. 7702B(a)(1).
- <sup>16</sup> Code Sec. 7702B(b).
- <sup>17</sup> Code Sec. 213(d)(10).
- <sup>18</sup> Code Sec. 7702B(d)(2).
- <sup>19</sup> Code Secs. 106(a) and 105(b).
- <sup>20</sup> Reg. §§1.105-5, 1.106-1.
- <sup>21</sup> Code Sec. 223(c)(2).
- <sup>22</sup> Code Sec. 707(c).
- <sup>23</sup> Code Sec. 162(a).
- <sup>24</sup> Code Sec. 162(l).

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