

Long-Term Care Insurance

By Julius H. Giarmarco, J.D., LL.M.

When advising clients with respect to their retirement planning, most attorneys, accountants and financial planners focus on the accumulation stage (e.g., how much needs to be saved annually to satisfy the client's retirement goals) and the distribution stage (i.e., how to "stretch" the retirement benefits to maximize the total after-tax payout). All too often, little or no consideration is given to the negative impact on retirement benefits if the participant incurs substantial long term health care costs. Such costs can easily exceed \$100,000 annually. Therefore, advisors should encourage their clients to purchase long term care (LTC) insurance to protect their desired retirement goals. LTC insurance will also protect the insured's children by preserving their inheritances.

Medicare and Medicaid

Many people (and advisors as well) mistakenly believe that Medicare and Medicaid will take care of most of their long term care needs. Medicare was designed for acute care – not ongoing long term care. Medicare only pays a portion of the first 100 days in a nursing home if certain criteria are met. Similarly, Medicaid is not a viable option to pay for long term care unless the individual can satisfy certain minimal income and asset tests. Moreover, Medicaid provides no assisted living care and very limited home health care.

Since studies predict that 40% of the 32 million Americans currently aged 65 and over will spend some time in a nursing home, prudence dictates that advisors prepare their clients for the costs of long term care. Aside from Medicare and Medicaid, which as seen above are not viable options for most people who have accumulated some degree of wealth, there are basically two solutions to planning for long term care – self-insurance and LTC insurance.

Self-Insuring

Certainly, for those persons who cannot afford the cost of long term care without jeopardizing their retirement goals, self-insuring is probably not an option. But what about wealthy individuals that have the ability to pay for long term care? They may be tempted to self-insure. But

individuals purchase homeowners insurance even though they have the ability to rebuild their houses in the event of a fire or other catastrophe. Yet the chance of losing a house to a casualty loss is 1 in 1200 compared to the chance of needing long term care (2 in 5 if one lives to age 65 and 1 in 2 after age 84). Therefore, advisors should be encouraging (or simply not discouraging) their clients to purchase LTC insurance.

LTC Insurance

LTC insurance is a policy which will provide coverage (via a prepaid indemnity expense incurred, or other benefit basis) for at least 12 consecutive months in a setting other than a hospital. The care typically includes diagnostic, preventative, therapeutic, rehabilitative, medically necessary or personal care. Such services may be provided in a nursing home, an assisted living facility, adult day care center, or at home. Most carriers provide a number of options in designing the coverage, including the daily or monthly benefit amount, cost of living riders, length of the benefit period, and the waiting period. In addition, there are many combination-type policies including shared LTC policies for couples/life partners, survivorship type benefits, LTC insurance coupled with annuities or life insurance, etc. Generally, the younger (and healthier) one is when the LTC policy is purchased, the lower the premiums.

Tax-Qualified Policies

Most LTC policies being offered by carriers today are "tax-qualified" ("TQ") policies. With a TQ policy, benefits may be paid when there is either (1) the need for "substantial"

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assistance with two of the six activities of daily living (i.e., eating, dressing, bathing, toileting, transferring and continence), or (2) the need for "substantial" supervision due to the presence of "severe" cognitive impairment (i.e., Alzheimer's, dementia or memory loss). In addition, a health care professional must certify that the care is likely to last 90 days.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) allowed for "eligible long term care insurance premiums" to be treated as a deductible medical expense (like accident and health insurance). Medical expenses are currently limited to the excess of 7.5% of the taxpayer's adjusted gross income. The amount of the LTC policy premiums eligible for the deduction is age-based and adjusted annually for inflation. Following are the limits established by the IRS for 2008:

<u>Attained Age Before Close of Tax Year</u>	<u>Maximum Deduction Per Individual</u>
40 or less	\$310
41 - 50	\$580
51 - 60	\$1,150
61 - 70	\$3,080
71 and older	\$3,850

In addition, long term care benefits are received tax-free up to \$280 per day (in 2008) and may be tax-free for more than that if the actual expenses exceed that amount.

Employer-Provided LTC Insurance

A self-employed individual may deduct 100% of the eligible premium for a LTC policy as an above-the-line business expense if: (1) the business pays the premium; and (2) the individual is not covered by a LTC policy maintained by the individual's or spouse's employer (whether or not the individual or spouse actually participates).

C corporations (including professional corporations) may deduct all premiums for the TQ LTC policies for their employees, spouses and eligible dependents. Even premiums in excess of the age-based limits described above are deductible. In addition, a plan may be selective, covering one or more employees/spouses based on classifications, and there can be different plans for different employees.

Partnerships and LLCs may deduct all premiums paid for LTC policies for their employees, their spouses and eligible dependents. A partnership or LLC may also pay premiums for its partners/members. As long as the premiums are paid without regard to the partnership's/LLC's income, they will be considered "guaranteed" payments. Therefore,

the premiums will be deductible by the partnership/LLC and includable in the partners'/members' income. The partners/members are then treated as self-employed individuals and follow the guidelines discussed above for self-employed persons with LTC insurance.

For an employee in a S corporation that does not own more than 2% of the issued and outstanding shares of the corporation on any day during the tax year, the entire TQ LTC premium for the employee, his/her spouse and dependents is deductible and the premium is not included in the employee's income. But if the employee owns more than a 2% interest in the S corporation, the employee is treated in the same manner as described above for partners/members.

Finally, if the employer and employee split the premium in a contributory plan, the employer receives the same federal income tax treatment described above, but only on the portion of the LTC premium it pays.

Health Savings Accounts

TQ LTC premiums are qualified medical expenses. As such, an individual may withdraw money tax-free from their HSA to pay TQ LTC premiums (with the age-based limits listed above).

Summary

In addition, to the tax advantages associated with LTC insurance described above, any one who can afford LTC insurance should seriously consider purchasing it for the following reasons:

1. They have assets they want to protect for retirement and/or inheritances.
2. They don't want to burden their family with extensive caregiving responsibilities.
3. They don't want to depend on government programs for care.
4. They want to choose the facility where they will receive the care.
5. They want to receive high quality care.

Finally, in some situations it may be advisable for children to purchase a LTC policy for their parents, particularly if the burden would be shifted to the children in the event care is needed but not affordable by their parents, or the children want to protect and preserve their inheritance.

Special Needs Trusts and Long-Term Care Planning

By Brenna D. Mansfield, J.D.

A Special Needs Trust (SNT) is a specialized trust that is designed to benefit a disabled person who is either already receiving means-tested government benefits, such as SSI or Medicaid, or is expected to receive such benefits in the future. An individual applying for means-tested benefits cannot have over \$2,000 in countable assets. Countable assets include cash or other liquid assets, or any real or personal property that an individual owns and can convert to cash. The assets in a properly drafted SNT are not considered countable assets for purposes of determining financial eligibility. A SNT may be either inter vivos or testamentary, and may be either self-settled or created by a third party.

Third-Party-Funded Special Needs Trusts (TPSNT)

It is quite common for parents or grandparents to want to leave assets to their disabled child or grandchild. However, an outright inheritance or gift will disqualify the disabled individual from receiving continued government benefits or from receiving them in the future. Assets placed in a TPSNT for the benefit of a disabled individual (by someone whose assets are not attributable to the individual) are not countable if the beneficiary has no legal authority to direct a distribution from the trust and does not have the right to direct that trust property reverts to him or her.

A TPSNT may be established for the benefit of any person who is deemed "disabled," regardless of whether the disabled person is related to the grantor. A person is considered disabled when all of the following are true: he/she has a medically determined physical or mental impairment, his/her impairment prevents him/her from engaging in any substantial gainful activity, his impairment can be expected to result in death, or has lasted at least 12 consecutive months, or is expected to last at least 12 consecutive months. A child under age 18 is considered disabled when he/she suffers from a medically determined impairment(s) of comparable severity.

A TPSNT allows trust resources to be available for the benefit of the disabled beneficiary without disqualifying him or her from receiving means-tested government benefits. However, government programs for beneficiaries with disabilities generally only provide the recipient with necessities. Funds in the TPSNT can be used for additional needs, such as furniture, electronics, vacations, housing, transportation, and uncovered medical services. In other words, trust property can be used for almost anything that will help improve the quality of care and life for the disabled individual without disqualifying them from

receiving government benefits. An additional benefit of the TPSNT is that after the disabled individual's death, any remaining trust property can then pass to the grantor's residuary beneficiaries named in the TPSNT.

Life Insurance in a TPSNT

Funding a TPSNT is also an important consideration. Care should be given in considering how much funding a TPSNT will have, given among other things, the age of the disabled beneficiary and the desire to provide for other children. Parents and grandparents may want to consider having the TPSNT purchase life insurance on the life of one or both parents. An insurance policy can provide income and estate tax benefits if the TPSNT is properly structured. In addition, the death benefit provides the TPSNT with significantly greater value than the cash incurred to pay premiums on the policy. Finally, the cash value accumulation within a permanent policy is not subject to federal income taxation. Overall, funding a TPSNT with life insurance provides tax-advantaged protection for the disabled beneficiary and peace of mind for the parents and grandparents.

Self-Settled Special Needs Trusts (SSSNT)

With a SSSNT, the beneficiary is the person who is also funding the trust (i.e. the grantor). Similar to a TPSNT, trust resources are available for the individual's benefit without being considered countable for eligibility purposes. However, in order for the assets in a SSSNT to be exempt for eligibility purposes, Michigan law mandates that the trust contain a provision stating that any medical assistance paid by the state on behalf of the beneficiary must be reimbursed from any amounts remaining in the trust upon the death of the beneficiary. After the state has been reimbursed, any remaining trust property can then be distributed to the trust's remainder beneficiaries.

The SSSNT is commonly used where a Medicaid or SSI recipient receives a gift, bequest, award, inheritance, or settlement that would otherwise disqualify him or her from continued government benefits. In order to preserve eligibility for these benefits, the individual's assets can be transferred to a SSSNT, which comes in two forms: the "Medicaid Payback Trust" (commonly known as a "D4A Trust") or the "Pooled Account Trust" (commonly known as a "D4C Trust").

The requirements of a valid "Medicaid Payback Trust" include:

- ◆ The individual beneficiary for whom the trust is created must be under age 65 when the trust is established and funded.
- ◆ The individual beneficiary for whom the trust is created must be disabled pursuant to the Social Security definition of "disability."
- ◆ The trust must ensure that none of the principal or income can be used for someone else during the disabled individual's lifetime.
- ◆ The trust must be established by a court or the individual's parent, grandparent, or legal guardian.
- ◆ The trust must be discretionary and irrevocable, meaning that the beneficiary cannot have the right to demand distributions nor can the beneficiary have the right to revoke the trust and have the assets revert back to him/her.
- ◆ The trust must provide that at the death of the beneficiary "the State will receive all amounts remaining in the trust ... up to an amount equal to the total medical assistance paid on behalf of the individual under a State plan."
- ◆ Accounts in the trust must be established by the disabled person's parent, grandparent, legal guardian, or by court order.
- ◆ Any trust funds remaining at the beneficiary's death must either be retained by the nonprofit corporation for the benefit of other disabled individuals, or the trust must impose upon the trustee an automatic duty to repay Medicaid upon the person's death.

Unlike the "Medicaid Payback Trust," a disabled individual does not have to be under age 65 to take advantage of a "Pooled Account Trust." Also unlike the "Medicaid Payback Trust," where family members can serve as the trustee, with this type of SNT, a non-profit organization establishes and manages a master trust, with separate trust accounts maintained for each disabled beneficiary of the trust. The non-profit organization acts as trustee and uses trust funds to pay for the supplemental needs of the disabled individual.

Divestment

A critical evaluation in establishing any form of SNT is whether a transfer into the trust constitutes a "divestment." A divestment is a transfer for less than fair market value that can result in periods of ineligibility for government benefits like Medicaid and SSI. With a TPSNT, transfers are not considered to be a divestment to the disabled individual since a third party's assets are the source of funding. Therefore, no divestment penalty applies to transfers into a TPSNT.

Transfers of property into a SSSNT are not considered to be a divestment, as long as the beneficiary is under age 65. For "Medicaid Payback Trusts," Michigan's Medicaid rules provide that transfers into such trusts for a beneficiary who is over age 65 will result in divestment penalties. The rule is the same for SSI. Michigan's rules for "Pooled Account Trusts" are highly ambiguous as they state that transfers to such a trust by a person age 65 or older "might" be a divestment.

Summary

A properly drafted Special Needs Trust provides the opportunity to achieve and preserve eligibility for government benefits and to supplement those benefits by providing for additional needs not covered by government programs. In any event, each individual situation needs to be thoroughly assessed as to whether the use of a SNT best suits the disabled individual's current and future needs.

Despite the "payback" requirement, the use of a "Medicaid Payback Trust" is beneficial in several ways. First, Medicaid for nursing home residents is the only government program that requires reimbursement, so the disabled individual may still qualify for other public benefits through use of the trust that do not require reimbursement. Second, Michigan does not charge interest on payments for care made on behalf of the Medicaid recipient. Third, the Medicaid pay rate for nursing home care is significantly less than the private pay rate. Thus, the total amount of reimbursement to the state will be less than what the disabled individual would have privately paid.

The requirements of a valid "Pooled Account Trust" include:

- ◆ The trust must be established by a nonprofit corporation.
- ◆ The trust must contain the resources of a person who is disabled.
- ◆ The trust must ensure that none of the trust principal or income can be used for someone else during the disabled individual's lifetime.
- ◆ A separate account must be maintained for each beneficiary of the trust, but for purposes of investment and management, the trustee may pool the accounts.

New ILIT Book Now Available

By Julius H. Giarmarco, J.D., LL.M.

The second edition of *A Practical Guide to Drafting Irrevocable Life Insurance Trusts* by my good friend and Troy, Michigan attorney, Sebastian V. Grassi, Jr., provides a comprehensive and practical guide to designing and drafting ILITs. I had the honor and privilege of being one of the editors of Sebastian's new book.

The book presents ideas and planning strategies for using ILITs to achieve the grantor's wealth transfer objectives with maximum flexibility. Sebastian's book covers the gamut. Starting with the benefits of an ILIT in Chapter 1, Sebastian then covers in subsequent chapters the income, gift, estate and generation skipping transfer tax issues that concern ILITs. In Chapter 10, Sebastian provides a checklist of ILIT drafting issues that is invaluable not only for drafting attorneys, but for any advisor who recommends an ILIT to a client. Chapter 11 covers techniques for making ILITs more adaptable to changes in the tax laws and in the grantor's personal situation.

My personal favorite is Chapter 14, which contains a description of 15 advanced ILIT planning opportunities. There is also a brand new chapter on fixing a "damaged" ILIT that attorneys and advisors will find very useful when they come across an outdated, poorly drafted or improperly administered ILIT. The book also has charts (one of which summarizes the differences between the most commonly used life insurance policies), checklists, numerous examples and sample clauses. There are also sample forms for single and joint life trusts for married couples and a sample trust form for an unmarried person's trust.

Although over 950 pages, Sebastian's book need not be read cover to cover to take advantage of its contents. The book is designed as a desk reference with quick and easy access to virtually every issue

that might arise in connection with an ILIT. Moreover, much of the book applies to all irrevocable trusts, not just ILITs. In short, I recommend *A Practical Guide to Drafting Irrevocable Life Insurance Trusts* to all of our newsletter subscribers. This valuable "how-to" practitioner/advisor-oriented book gives you the information on ILITs that you need to properly advise your clients.

Sebastian V. Grassi, Jr., a nationally recognized expert on estate planning, has penned a book that should be on the desk of every person who advises clients with respect to ILITs. You can purchase Sebastian's book and view its table of contents by visiting www.aliaba.org/aliaba/BK45 or by calling (800) 253-6397.

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