Wealth Preservation and
LTCI Planning Consultants

HOW A LONG TERM CARE INSURANCE TRUST CAN INCREASE THE VALUE OF ONE'S ESTATE

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Achieving the top strata of net worth has its advantages and its challenges. To address the challenges, persons of exceptional wealth enlist the assistance of trusted advisors to manage their planning needs.

There are many risks subject to such management, not the least of which is the risk of a debilitating injury or illness, or onset of a chronic condition requiring extended health care. Why should ultra-high net worth clients address this risk? Why should financial advisors include planning for this risk alongside traditional wealth management efforts?

Risk: According to the US Department of Health and Human Services – as well as a study done by Penn State University – for individuals who reach age 65, 7 out of 10 will require some level of extended health care in their remaining lifetime due to fragility, chronic, or cognitive conditions due to longevity.

The typical response to the invitation to plan for long-term care is that these clients can easily self-insure the costs of such care. But are these clients prepared to invest the time and emotional capital needed to treat a family member who requires extended health care? A trusted financial advisor would be remiss in failing to bring this aspect of risk and best solutions to the attention of their clients.

Long-term care planning offers peace of mind through the employment of experts to oversee care (Health Care Advocacy). The value of this expert care management and coordination is a key benefit to a comprehensive long term care planning strategy.

A comprehensive long term care plan could potentially produce significant savings to the client's estate. While ultra-high-net-worth individuals certainly have the assets to self-insure, long term care planning is an effective tool for asset preservation and risk management. **Combining a special long term care insurance policy with an irrevocable trust can be a winning tax-advantaged wealth preservation strategy.**

The reason: there is <u>no</u> cost to the individuals' estates if they never need long term health care, but a <u>huge</u> financial upside if they do.

To assist in determining if an extended health care plan – combined with an irrevocable trust – is an effective tax-advantaged wealth preservation strategy, consider the following points:

- The **four** costs of long term health care.
- How a "**cash**" long term care insurance policy – combined with a **premium refund** feature – can produce a "no-lose" financial transaction.

- How long term care insurance can be owned by an **irrevocable trust**.
- The tax, cost, and benefit **statistics** of how the trust owned policy could work for your – and why it can **only** produce tax advantaged results for them.

Understanding the four costs of long term health care

In addition to the actual out-of-pocket cost of care, there are **three** other hidden costs:

1. The **opportunity** cost of care payments
2. The possible **tax liability** when assets are sold at a profit to pay care costs.
3. The possible **economic cost** of liquidating assets at a **loss** to pay for care.

What is a "cash" long term care insurance policy with a premium refund feature?

To **qualify** to receive long term care insurance benefits, an individual must either require **assistance or supervision** in two or more of their activities of daily living (eating, dressing, bathing, transferring, continence and toileting) or have a **cognitive imp**airment – such as Alzheimer's – that requires constant supervision.

Once you qualify for benefits, the type of policy you own will determine how much you will be paid:

- If you have a **reimbursement** policy you will be paid the amount of actual, incurred expenses.
- If you have an **indemnity** policy, you will be paid its daily benefit as long as you incur one dollar or more of actual expense.
- If you have a **cash** policy, you will be paid 100% of your benefit **regardless** of the amount of expenses you incur – if any (and benefit payments in excess of $290 a day of actual expenses may be taxable, if the full benefit is not used for care).

Therefore a "cash" policy provides **certainty** that, once you qualify for benefits, you will never be paid less than 100% of your benefit.

The **premium refund** feature takes that guarantee one step further – it provides that when you die the insurance company will refund to your beneficiaries **100%** of your premiums, less any benefits you have received. Therefore the premium refund feature **guarantees** that either you personally, or your beneficiaries, will never receive **less** than the premiums you have paid. As a result, the maximum cost of your insurance – should you never need care – is the **opportunity cost** of money: the interest you could have earned on your premiums had you invested them.

And, as we will shortly see, the **tax subsidy** your estate can receive at your death can eliminate that cost.

How can an irrevocable trust own a long term care insurance policy?

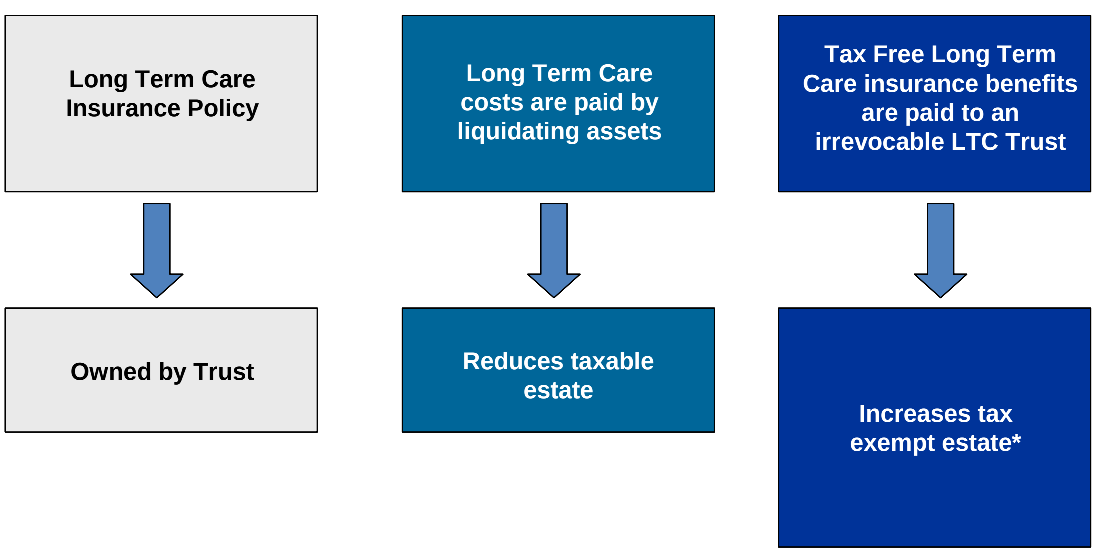
Several insurance companies allow **ownership** of a qualified long term care insurance contract by a **third** party – including a trust. And some tax authorities believe that a long term care insurance policy owned by an irrevocable trust can be an effective **wealth preservation**/transfer strategy that would work like this:

- The individual will intend to pay the costs of long term health care from their assets (which would require that they have liquid assets on hand to make the payments). These payments will **reduce** his taxable estate.
- An **irrevocable trust** will be created which buys a long term care insurance policy.
- The grantor finances the purchase of the insurance by making **gifts** to the trust (a portion of the gift may qualify for the medical care gift tax exclusion).
- Should the individual need long term health care the insurance company will pay the benefits to the **trust** – which presumably would be treated as amounts received for personal injuries and sickness and as reimbursement for expenses actually incurred for medical care.
- The trustee would **inves**t the insurance payments made to the trust – if the individual needs care – for the benefit of the trust beneficiaries.
- At the **death** of the individual:
  - The amount in the trust would **not** be subject to the estate tax.
  - The estate would be **reduced** by the payments from it for the cost of the individual's long term insurance policy and that reduction would in turn, reduce the estate tax.
- Should the individual die without having received benefits, the insurance company would **refund** the **trust** the sum of its premium payments and the refund would presumably be estate **tax exempt**.

(Note: Only an individual's professional tax advisors are capable of determining if this strategy should be used and MS Consulting Group LLC does not provide tax advice. For a detailed discussion of Third Party Owned Long Term Care Insurance, see the MassMutual Law Department's July 2008 Advanced Underwriter entitled "Long Term Care Insurance, a Tax Primer")

Visually, the strategy looks like this:

LTCI to reduce Estate Taxes



Here's an example of how this strategy would work for your valued client:

In our financial models here are the assumptions we are using:

- Valued Client' $20,000,000 of securities is increasing each year at a 6% rate – 3.6% after tax.
- In Model 1, Valued Client dies at age 88 without ever needing care.
- In Model 2, Valued Client needs long term health care beginning at age 80 for 8 years at which time he dies.
- The current cost of long term health care at home is $175,000 a year and it increases at 5% a year.
- The estate tax rate is 50%.

Model 1 Results*

Valued Client dies at age 88 without ever needing care

	Without Insurance	With Insurance
• Value of estate at age 88	$53,839,764[(1)]	$52,295,347[(2)]
• After 50% estate tax	$26,919,882	$26,174,674
• Premium refund to trust	$ 0	$ 840,000[(3)]
• Total estate	**$26,919,882**	**$26,987,674**

(1) $20,000,000 accumulating at 3.6% for 28 years.
(2) $20,000,000 less $30,000 annual gift accumulating at 3.6%. for 28 years
(3) $30,000 premium (x) 28 years.

In this case, Valued Clients' estate will be worth **more** had he purchased the insurance – even though he never received benefits – than if he had not because (1) 50% of the premiums – and the interest they could have earned – have effectively been **discounted** by the estate tax and (2) the **premium refund** is income **tax free** and (presumably) estate **tax exempt**.

And even if it were determined that the premium refund was subject to the estate tax the cost to the estate of owning the insurance would be deminimus. Therefore, under the assumptions we used to make this model, there is no downside to owning the insurance.

Model 2 Results

Valued Client needs care at age 80 for 8 years and then dies

	Without Insurance	With Insurance
• Value of estate at age 80	$40,571,877[1]	$39,620,809[2]
• Care costs for 8 years	($ 4,433,910)[3]	($ 4,433,910)[3]
• Estate value at age 88	$48,670,832[4]	$47,126,415[4]
• After 50% estate tax	$24,335,416	$23,563,207
• Insurance paid to trust	-	$ 4,504,537
• Earning on insurance @ 3.6%	-	$ 727,476
• Total estate	**$24,335,416**	**$28,795,220**

1. $20,000,000 accumulating @ 3.6% for 20 years.
2. $20,000,000 less $30,000 annual gift accumulating @ 3.6%. for 20 years (the premium is waived when benefits are paid)
3. $175,000 cost of care has inflated @ 5% to $464,327 in 20 years.
4. Estate continues to grow @ 3.6% after care costs.

Further, if a trust is **not** desired to produce the estate tax results illustrated –and to provide a vehicle to transfer wealth to family members-- it is possible to achieve almost the **same** economic results without it through a comprehensive product design and tax strategy.

One last point: the tax strategy outlined in this article assumed that the client had **liquid assets** available to pay the costs of care if they are incurred. But what if this was **not** the case?

For example, let's assume the bulk of his estate is in real estate, or investment accounts with a value greater than cost, or investment accounts with a value less than cost. In this asset environment, the liquidation of assets to pay care costs would have **severe** economic or tax consequences because it would either create **tax liabilities** or create an **economic loss**. Therefore the client should purchase long term care insurance to **eliminate** the need to liquidate assets, if care is needed, by creating **liquidity**.

Further, although a trust did not own the policy, his premium payments are still **reducing** his taxable estate. Therefore, at his death, the **reduction** in his estate tax has effectively paid a substantial portion of his premiums.

Note: Our Software System will run models with and without trust ownership so you can compare the results of both strategies.

Conclusions

- If long term health care is **never** needed, there will be **no** cost to the clients' estate at his death with the use of the trust -and only a deminimus cost if a trust is not used...

- If long term health care **is** needed the insurance purchase – with or without trust ownership – can significantly **increase** the clients' assets for the benefit of his family or charitable interests.

- If the clients' assets are **not** liquid – or would create tax liabilities when sold – long term care insurance is **essential** to provide the funds to pay the costs of care, and eliminate the adverse tax or economic consequences that would result from their sale.

- Managing the long-term care risk takes much more than money. It takes care, oversight, expertise and a comprehensive plan. Financial Advisors looking to distinguish themselves as total service providers to existing and potential clients must address this risk. If a care event strikes, financial advisors that fail to do so face possible questions and potential litigation from the beneficiaries of the estate as to why discussion of this risk was not addressed, particularly given the probability that one would need care.

- While ultra High Net Worth clients have the resources to avail themselves of any of the alternatives -- self-insurance, investment funds and LTC-insurance – only the LTC insurance option meets the need of finding expert care with maximum financial leverage. The benefits of the LTC insurance option are readily apparent and best serve the financial advisor and their clientele in meeting the long-term care risk.

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