A new long term care health insurance strategy to conserve assets, reduce estate taxes and transfer wealth.

Long term care insurance is an attractive investment alternative that has a multi-million dollar upside and little, or no, downside risk:

- If your clients need long term health care they can be paid millions of dollars of tax-free insurance payments.

- If your clients never need long term health care the insurance company will refund their premiums payments when they die.

- Tax subsidies may substantially reduce your clients’ premium costs.

In addition to being income tax free, insurance payments to your clients can be estate tax-exempt and creditor proof.

This means there is no longer any reason that your clients need to pay long term health care costs by liquidating assets.
Summary

To demonstrate how long term health care insurance can conserve assets, let's look at an investor residing in New York State who is 55 years of age and has an estate of $8,000,000 earning 7% before tax. His marginal state and federal income tax bracket is 40%, the estate tax rate is 35% and he has a $10,000,000 exemption. The current cost of long term health care is $175,000 a year and it is increasing at 5% per year.

**Assumption 1**

At age 75 the Investor needs 8 years of extended health care for a total cost of $4,436,979 and dies at age 82

Total value of investor's estate at age 82 after estate taxes:

1. Without long term care insurance $17,369,691
2. With insurance and an irrevocable trust $21,717,979
3. Gain $4,348,288

**Assumption 2**

At age 82 the Investor dies without ever needing extended health care and has paid $392,000 in long term care insurance premiums

Total value of investor’s estate at age 82 after estate taxes:

1. Without long term care insurance $19,955,060
2. With insurance and an irrevocable trust $19,956,134
3. Loss $0

In this example – using an irrevocable trust – the family’s assets were increased by 25% if extended health care had been provided – but at no cost to the estate if care was never needed.
This White Paper will discuss the following subjects:

- The **risk** (odds) that investors will need extended health care.

- The **cost** of extended health care including the loss of investment earnings and possible tax and liquidation surcharges.

- How to use the insurance to **reduce** estate tax liabilities and transfer wealth.

- How to **quantify** the insurance as a financial transaction.

- A specific **example** of how long term care insurance can significantly **enhance** the value of an estate with little or **no** cost to it if extended care is never needed.

- **Recent** developments in the long term care insurance marketplace.

### The Extended Health Care Risk

70% of all individuals who reach age 65 will need some kind of extended health care and **twenty percent** of them will need it for more than **five** years:

![Who will need long term health care?](image)

Out of every 100 individuals living beyond age 65:

- **30** will need care for less than 1 year
- **18** will need care from 1 to 2 years
- **12** will need care from 2 to 5 years
- **20** will need care for more than 5 years


[1] “Alzheimer’s Disease is a chronic disease that starts with mild memory problems and ends with severe brain damage. The time from diagnosis to death varies — as little as 2 or 3 years if the person is older than 80 when diagnosed to as long as 10 or more years if the person is younger.” U.S. National Institute on Aging/Alzheimer’s Disease Fact Sheet 2020.
There are two facts that are not shown in this chart:

- Continuing advances in medical science mean longer life expectancies. As a result, diseases that used to kill people now just disable them. This means that more people will need extended health care than ever before and that they will need it for longer periods of time.

- The odds that an investor has a 70% chance of needing extended health care after age 65 also applies to his or her spouse, making it highly likely that at least one of them will need care at some time during their lifetimes.

**The Costs of Extended Health Care**

Here are three important findings from the 2010 surveys of extended health care costs made by the MetLife Mature Market Institute and the Prudential Life Insurance Company:

- The cost of 24/7 home care – the type that might be needed for an Alzheimer's patient – is $175,000 a year.

- The annual cost of a private nursing room varies widely with location, but can run over $160,000 a year in many large metropolitan areas.

- Since 2004, long term care costs have grown at the rate of 4.7% to 6.6% a year – or a total increase of 31% to 47% depending on the type of care.
In many cases the costs of extended health care will be minor. But when care is needed for years, costs can run into the millions of dollars. For example:

<table>
<thead>
<tr>
<th>Year care begins</th>
<th>For 1 year</th>
<th>For 8 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>$175,000</td>
<td>$1,671,094</td>
</tr>
<tr>
<td>2021</td>
<td>$285,056</td>
<td>$2,722,040</td>
</tr>
<tr>
<td>2031</td>
<td>$464,327</td>
<td>$4,433,909</td>
</tr>
</tbody>
</table>

However, the total cost of extended health care can exceed the costs of the care itself because these additional expenses:

1. The Investment Surcharge.
2. The Tax Surcharge.
3. The Liquidation Surcharge.
1. **The Investment Surcharge:**

   If an individual is in a nursing home for 8 years and the cost is $175,000 a year, the total expense – assuming a 5% inflation rate – will be **$1,671,094**. But every dollar of assets **liquidated** to pay those costs (or income used for the same purpose) is a dollar that can no longer be invested. For example, assuming a 4% after tax return:

<table>
<thead>
<tr>
<th>Loss of assets to invest for 8 years:</th>
<th>$1,671,094</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total loss in 20 years at 4%:</td>
<td>$3,172,818</td>
</tr>
<tr>
<td>In this case the total cost of care was:</td>
<td></td>
</tr>
<tr>
<td>Direct costs:</td>
<td>$1,671,084</td>
</tr>
<tr>
<td>Opportunity costs @ 4%:</td>
<td>$1,501,734</td>
</tr>
<tr>
<td></td>
<td>$3,172,818</td>
</tr>
</tbody>
</table>

2. **The Tax Surcharge:**

   Now let’s assume the same $1,671,094 in care costs for 8 years, but this time they are paid from **withdrawals** from an **IRA** account. In this case, in a 40% bracket, the individual would have to withdraw **$2,785,157** to pay $1,671,094 of care costs:

   | Total withdrawals for 8 years:        | $2,785,157 |
   | Total loss of IRA assets in 20 years at 4%: | $5,288,029 |

   If investment profits have to be liquidated to pay care costs, the tax surcharge becomes the **capital gains** tax rate.
3. **The Liquidation Surcharge:**

If the only assets on hand to pay extended health care costs are *illiquid* – such as real estate or stock in a closely held company – the investor may have to sell off assets at a *loss*.

**How to use Long Term Care Insurance to Reduce Estate Taxes**

Many tax authorities believe that a long term care insurance policy owned by an irrevocable trust will produce these *tax-advantaged* results:

- Insurance benefits payable to the trust will *not* be taxable as income.
- Trust assets will *not* be included in the insured’s taxable estate.
- Trust assets will be *protected* from claims of the insured’s creditors.

Here is how the strategy can work:

- The investor creates and funds an **irrevocable trust** which then purchases a long term care insurance policy.
• If the investor **needs** extended health care, he or she plans to pay for it by **liquidating** assets – which reduces the taxable estate. At the same time, the insurance company will pay insurance benefits into the trust.

• If the investor dies **without** ever needing extended health care, the insurance company will **refund** the premiums to the trust.

*The tax issues involved with this strategy are complex and should be carefully reviewed with the investor’s professional advisors.*

**Quantifying Long Term Care Insurance as a Financial Transaction**

Let’s say that an investor is 55 years of age, lives in New York, is planning on retiring in 10 years, and has $8,000,000 in his investment and qualified retirement plan accounts.

His advisor tells him that if he – or his wife – were to need extended health care, the cost of it could run into the millions of dollars and suggests the following long term care insurance solution:
Age 55 – Long Term Care Insurance Benefits and Costs

$14,000 annual premium (1) ($11,200 after New York State Tax Credit) $182,500 annual benefit, 5% COLA

<table>
<thead>
<tr>
<th>Premium Age</th>
<th>1 year</th>
<th>ROI</th>
<th>8 years</th>
<th>ROI</th>
<th>Refund</th>
<th>ROI</th>
</tr>
</thead>
<tbody>
<tr>
<td>55</td>
<td>$182,500</td>
<td>1529%</td>
<td>$1,742,712</td>
<td>1634%</td>
<td>$14,000</td>
<td>25.0%</td>
</tr>
<tr>
<td>65</td>
<td>$297,273</td>
<td>14.2%</td>
<td>$2,838,692</td>
<td>35.3%</td>
<td>$154,000</td>
<td>3.7%</td>
</tr>
<tr>
<td>75</td>
<td>$484,227</td>
<td>6.2%</td>
<td>$4,623,936</td>
<td>18.9%</td>
<td>$294,000</td>
<td>1.9%</td>
</tr>
<tr>
<td>85</td>
<td>$788,754</td>
<td>4.7%</td>
<td>$7,531,898</td>
<td>13.7%</td>
<td>$434,000</td>
<td>1.4%</td>
</tr>
</tbody>
</table>

(1) This analysis is not an insurance proposal and illustrates only hypothetical results. The insurance benefits that you may be entitled to will depend upon the exact terms and conditions of your policy. The amount of actual tax credits, tax deductions, and tax obligations you can receive – if any – will depend on your own individual circumstances and therefore it is imperative that you consult with your professional advisors regarding them. We do not provide tax advice and this material is not for use by any taxpayer to avoid any Internal Revenue Service penalties.

(2) Long term care insurance premiums are not guaranteed and can be changed on a class basis by the insurance companies with the permission of the state regulatory authorities.

Other Features and Benefits

- At death, the insurance company will refund 100% of the premiums, less any benefits received.
- The policy can be owned by an irrevocable trust as part of a strategy to reduce estate taxes and transfer wealth.
- A portion of the premium may be an above the line tax-deduction on the Federal return for sole proprietors, partners in partnerships, 2%+ shareholders in ‘S’ corporations, and LLC members.
- New York State residents may be eligible for a 20% tax credit.
• If an employer pays the premium:
  
  - It is **deductible** to the employer (and may also qualify for the New York State Tax credit), but it is **not** taxable to the employee.
  
  - The premium refund is payable to the employee’s **personal** beneficiaries (and may be taxable to them).

**Recent Developments in the Long Term Care Insurance Marketplace**

Many of the large long term care insurance companies have **lost** significant amounts of money underwriting the business and, as a result, some of them have requested significant rate increases while others – like MetLife and Allianz – have decided to exit the long term care insurance business.

These actions mean **two** things to individuals who care considering buying long term care insurance: (1) the **need** for extended health care is far greater than the insurance companies predicted and investors who do not plan on how to pay for it are placing their assets at risk and (2) careful **due diligence** is necessary to pick the insurance carrier least likely to raise its rates in the future.

Although financial ratings are important in this search, there are two other factors that – in our view – are just as relevant:

• The insurance company’s **record** of rate increases, their premium income and claims payments, and the relationship of their claims to expected claims. A great deal of this information is available in the *National Association of Insurance Commissioners Long Term Care Insurance Experience Reports* and it should be a must read by any individual that is considering the purchase of long term care insurance.
The percentage of the insurance company's long term care insurance premium income to its total premium income. The larger this percentage, the more sensitive the company will be to the experience in its long term care insurance block of business; the lower the percentage, the less important that experience becomes in terms of overall company profitability.

It is impossible, of course, to accurately predict which insurance companies will raise their premium rates in the future. But careful due diligence can help minimize that risk.

Note: A hedge against a rate increase is the Return of Premium feature that guarantees a refund of all premiums at the death of the insured, less any benefits received.

A Specific Example of How Long Term Care Insurance can Protect Assets

An investor is age 55 and has an $8,000,000 taxable estate. He purchases long term care insurance policies for himself and his wife that will pay each of them $182,500 a year increasing at 5% a year if they need extended health care (the annual premium for each policy is $14,000). His financial planner suggests that he considers the use of an irrevocable trust to own the insurance as part of a strategy to reduce future estate taxes.

The following financial examples were calculated using Corporate Compensation Plans' proprietary WealthSecure® software and illustrate the following results:

- **Assumption 1**: The investor needs extended health care:
  - Without owning long term care insurance.
  - With insurance and an irrevocable trust.
  - With insurance and without the trust.

- **Assumption 2**: The investor does not need extended health care:
  - If he did not own insurance.
  - If insurance had been purchased and owned by a trust.
  - If insurance had been purchased without trust ownership.

See the software's examples in the following pages.
Summary of Results

**Current Status**

Age 55: $8,000,000 of investment assets, 7% interest, 40% income tax bracket, 35% estate tax bracket, current annual care cost of $175,000 increasing at 5%

**Assumption 1**

At age 75, individual needs 8 years of extended health care for a total cost of $3,325,433 (after taxes) and dies at age 82.

Total value of investor’s estate age 82:

1. Without long term care insurance $17,369,691
2. With insurance and an irrevocable trust $21,717,979
3. With insurance and without the trust $19,782,267

**Assumption 2**

Individual dies at age 82 without ever needing extended health care and has paid $392,000 in long term care insurance premiums.

Total value of investor’s estate at age 82:

1. The investor did not buy insurance $19,955,060
2. The investor bought insurance and used a trust $19,956,134
3. The investor bought insurance and did not use a trust $19,818,934

In this example – using an irrevocable trust – the family’s assets were increased by 25% if extended health care had been provided – but at no cost to the estate if care was never needed.

The financial details used in these assumptions are shown on the next two pages.
### Assumption 1

Example - in 2011, a 55 year old individual buys Long-Term Care insurance with a $182,500 annual benefit. At age 75 he or she is disabled from Alzheimer’s and needs Long-Term Care, then dies 8 years later at age 82.

<table>
<thead>
<tr>
<th></th>
<th>Without Insurance</th>
<th>With the insurance and LTC Trust</th>
<th>With the insurance and no Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of estate at age 76</td>
<td>$18,216,637</td>
<td>$17,982,814 (1)</td>
<td>$17,862,814</td>
</tr>
<tr>
<td>Cost of Long-Term Care (2)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At Age 75 - $644,327</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At Age 83 - $1,013,305</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total for 8 years</td>
<td>$3,326,433</td>
<td>$4,433,510</td>
<td>$4,433,510</td>
</tr>
<tr>
<td>Insurance Benefits</td>
<td>$0</td>
<td>$0</td>
<td>$4,620,805</td>
</tr>
<tr>
<td>Value of estate at death at age 82 (3)</td>
<td>$21,337,086</td>
<td>$19,516,034</td>
<td>$25,040,041</td>
</tr>
<tr>
<td>Evasion</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Taxable Estate</td>
<td>$11,337,086</td>
<td>$9,516,034</td>
<td>$10,040,041</td>
</tr>
<tr>
<td>Estate Tax @ 35%</td>
<td>($3,000,000)</td>
<td>($3,311,662)</td>
<td>($3,577,075)</td>
</tr>
<tr>
<td>Value of estate before insurance payments</td>
<td>$17,337,086</td>
<td>$16,204,372</td>
<td>$16,463,375</td>
</tr>
<tr>
<td>Long-Term Care insurance payments to the trust from age 75 to 82</td>
<td>$0</td>
<td>$4,623,056</td>
<td>$0</td>
</tr>
<tr>
<td>Earnings on insurance payments at 4.2%</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Return of Premium</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Total Trust Assets</td>
<td>$4,620,805</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>TOTAL ESTATE</td>
<td>$17,337,086</td>
<td>$21,717,075</td>
<td>$16,463,375</td>
</tr>
<tr>
<td>GAIN</td>
<td>$0</td>
<td>$4,443,510</td>
<td>$0</td>
</tr>
</tbody>
</table>

1. Taxable cost of beginning life insurance.
2. Assumes Long-Term Care is $644,327 1st year, $1,013,305 2nd year and $1,040,041 3rd year.
3. Assumes death occurs before 10/1 of any year, after Long-Term Care payments have been made.

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Assumption 2

Example - in 2011, a 55 year old individual buys Long-Term Care insurance with a $182,500 annual benefit. At age 82 he or she dies without having ever needed any long-term care.

<table>
<thead>
<tr>
<th></th>
<th>2.1 Without insurance</th>
<th>2.2 With the insurance and LTC Trust</th>
<th>2.3 With the insurance and no Trust</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of estate at death at age 82 (2)</td>
<td>$25,316,477</td>
<td>$26,714,053</td>
<td>$24,714,053</td>
</tr>
<tr>
<td>Return of Premium</td>
<td>50</td>
<td>50</td>
<td>$92,680</td>
</tr>
<tr>
<td>Value of Estate</td>
<td>$25,316,477</td>
<td>$26,714,053</td>
<td>$25,150,053</td>
</tr>
<tr>
<td>Exemption</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Taxable Estate</td>
<td>$15,316,477</td>
<td>$14,714,053</td>
<td>$15,150,053</td>
</tr>
<tr>
<td>Estate Tax @ 36%</td>
<td>$9,599,417</td>
<td>$5,140,019</td>
<td>$5,287,119</td>
</tr>
<tr>
<td>After Tax Estate</td>
<td>$10,255,060</td>
<td>$12,554,134</td>
<td>$12,818,934</td>
</tr>
<tr>
<td>Return of Premium to Trust</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>TOTAL ESTATE</td>
<td>$10,255,060</td>
<td>$12,554,134</td>
<td>$12,818,934</td>
</tr>
<tr>
<td>GAIN</td>
<td>--</td>
<td>$1,514</td>
<td>($16,425)</td>
</tr>
</tbody>
</table>
Note: If you would like to see a personalized WealthSecure report for yourself or one of your clients call Tasha Mayberry at 203.792.7300.

Conclusions

- Many investors will never need extended health care – but 20% of them will need care for five years or more after they become age 65.

- The cost of a short period of extended health care can be inconsequential – but the costs from diseases such as Alzheimer’s or Parkinson’s, or from serious injuries or strokes, can run into the millions of dollars. These costs, plus their lost investment potential, will reduce investors’ legacies for their families and for their charitable interests.

- Long term care insurance can be purchased to eliminate the loss of assets and income that result from extended health care with this very attractive value proposition:
  - If care is needed, the insurance company will pay for it.
  - If care is not needed, the insurance company will refund the premiums with the result that there will be little, if any, cost to the estate from the purchase of the insurance.
  - The use of an irrevocable trust may allow the investor to reduce his or her estate taxes.
  - Tax subsidies may pay a substantial part of the premium.

For more than 25 years Corporate Compensation Plans has been designing and administrating innovative and tax-effective benefit programs for many of the country’s largest corporations and law firms. For more information about us visit our website at www.corpcompinc.com or call us at 800.334.6447.