Efficient Long-Term Care Risk Coverage for the Affluent

Seven often unconsidered consequences of self-funding long-term care

Deciding which path to take

- The false dichotomy when planning for long-term care
  - Medicaid or self-fund
    - Impoverishment or face a cycle of ever-increasing taxation (without the ability to shift risk – there is no such thing as self-insuring)
  - Asset-based LTC protection may prove to be the most efficient method of paying LTC costs
    - Avoiding the seven unconsidered consequences: 1) Sequence of return risk; 2) Tax exposure risk; 3) Loss of step-up in basis; 4) Compromising business succession plans; 5) Exposure to filial laws; 6) Inefficient use of trust assets; and, 7) Inefficient use of business income

Accumulation and sequence of return risk

Sequence of Returns Risk — Accumulation rates of return

$1,000,000 Beginning Account Value					
Sequence 1	Rate of Return	Account Value	Sequence 2	Rate of Return	Account Value
Year 1	10.0%	$1,100,000	Year 1	0.0%	$1,000,000
Year 2	8.0%	$1,188,000	Year 2	12.0%	$1,120,000
Year 3	2.1%	$1,212,948	Year 3	4.0%	$1,164,800
Year 4	-5.0%	$1,152,301	Year 4	8.0%	$1,257,984
Year 5	20.0%	$1,382,761	Year 5	15.0%	$1,446,682
Year 6	15.0%	$1,590,175	Year 6	20.0%	$1,736,018
Year 7	8.0%	$1,717,389	Year 7	-5.0%	$1,649,217
Year 8	4.0%	$1,786,084	Year 8	2.1%	$1,683,851
Year 9	12.0%	$2,000,414	Year 9	8.0%	$1,818,559
Year 10	0.0%	$2,000,414	Year 10	10.0%	$2,000,414

Note: *For illustration purposes only and is not to be construed as indicative of any actual investment*

Decumulation and sequence of return risk

Sequence of Returns Risk — Decumulation Rates of Return

$1,000,000 Beginning Account Value			$100,000 Annual Withdrawal		
Sequence 1	Rate of Return	Account Value	Sequence 2	Rate of Return	Account Value
Year 1	10.0%	$990,000	Year 1	0.0%	$900,000
Year 2	5.0%	$934,500	Year 2	-12.0%	$704,000
Year 3	-4.0%	$801,120	Year 3	-15.0%	$513,400
Year 4	8.0%	$757,210	Year 4	3.0%	$425,802
Year 5	15.0%	$755,791	Year 5	8.0%	$351,866
Year 6	8.0%	$708,254	Year 6	15.0%	$289,646
Year 7	3.0%	$626,502	Year 7	8.0%	$204,818
Year 8	-15.0%	$447,527	Year 8	-4.0%	$100,625
Year 9	-12.0%	$305,823	Year 9	5.0%	$656
Year 10	0.0%	$205,823	Year 10	10.0%	$(109,278)

Note: *For illustration purposes only and is not to be construed as indicative of any actual investment*

All retirement income is not created equal

- The “X”s reveal exposure to taxes and surcharges.
- Reducing exposure to taxes, penalties and surcharges means increasing net after-tax income.
- The fewer “X”s the better.

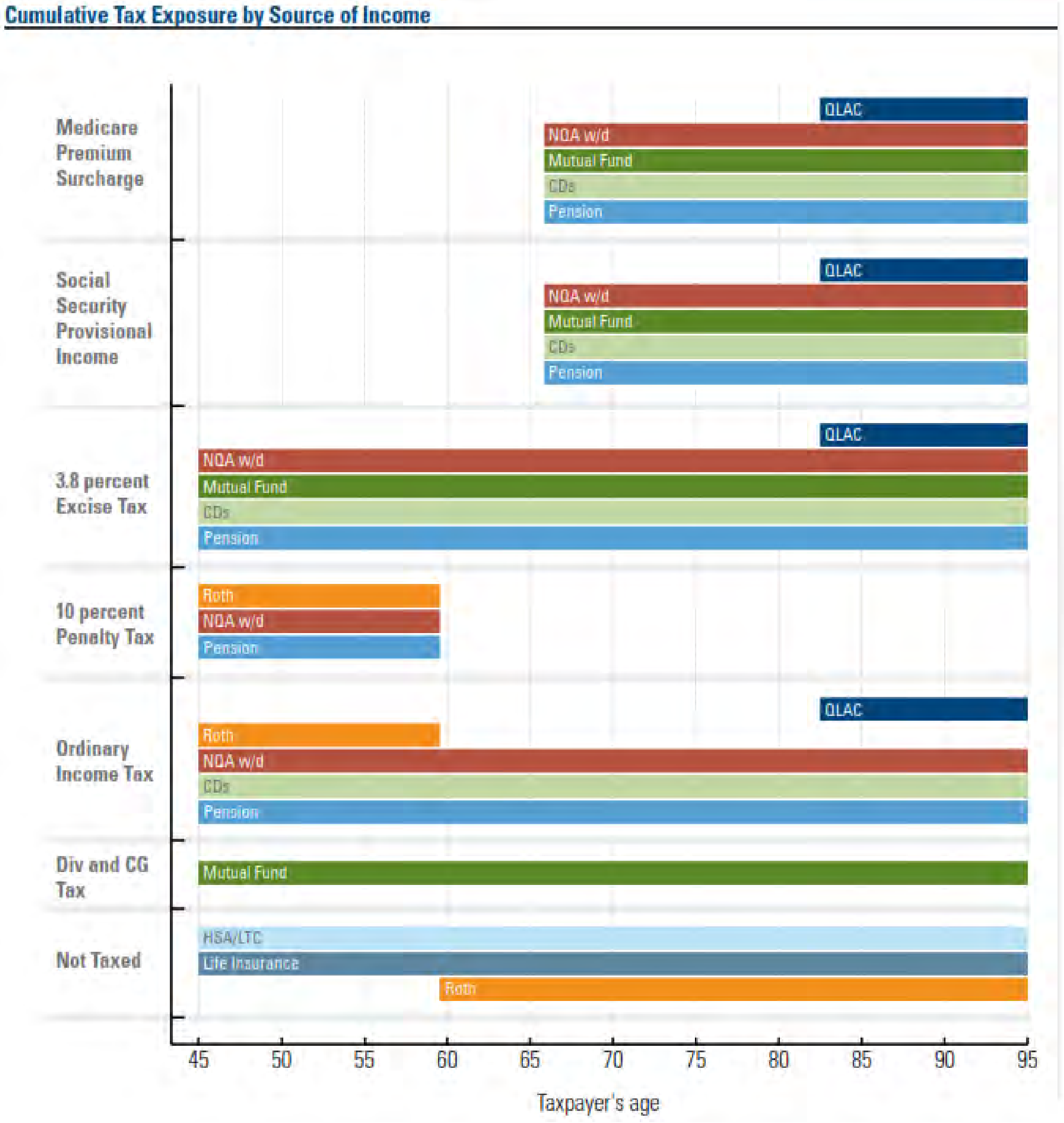
Income type and exposure to taxes and surcharges

	Subject to FICA up to wage cap	Subject to ordinary income rates	Subject to capital gains rates	Subject to qualified dividend rates	Subject to 10% Penalty tax	Included for 3.8% excise tax	Included for Medicare surcharge	Included in Provisional income
Wage income	X	X				X	X	X
Deferred Compensation Payments	Potentially	X				X	X	X
Pension and IRA income		X			X	X	X	X
Interest income		X				X	X	X
Distributions from pass-throughs on K-1		On income	On capital gain	On qualified dividends		X	X	X
Deferred annuity LIFO withdrawals		to basis			X	To basis	To basis	To basis
Qualified Dividend income				X		X	X	X
Capital gain income (real estate and stock sales)			X			X	X	X
Annuity payments with exclusion ratio		Partially				Partially	Partially	Partially
Social Security income		Provisional calculation				Provisional calculation	Provisional calculation	Provisional calculation
Tax-exempt bond income								X
Loans (life insurance and reverse mortgage)								
Roth qualified withdrawals								
Life insurance FIFO withdrawals to basis								
Qualified HSA payments								
Qualified LTCI payments								

How much tax is applied to the "color" of your income?

- How many bars of taxes and surcharges do you want your retirement distributions to be subject to?
- The colors that appear only once on this chart are life insurance withdrawals to basis, qualified HSA distributions and qualified LTCI distributions.
- Roth is next with only pre-59 ½ distributions being subject to tax.

For use with financial professionals only. Not for public distribution



Think Social Security benefits are not taxed. Think again.

Taxation of Social Security Benefits

Single		Married	
Provisional Income	Taxation	Provisional Income	Taxation
Under $25,000	0%	Under $32,000	0%
$25,000–$34,000	50%	$32,000–$44,000	50%
Above $34,000	85%	Above $44,000	85%

IRMA – Means testing in Medicare

The brackets in 2021 for Medicare Part B income-related monthly adjustments

MAGI for Individuals	MAGI for Married filing jointly	Part B Monthly premium amount	Income Related Monthly Adjustment Amount
≤ $88,000	≤ $176,000	$148.50	$0
$88,001–$111,000	$176,001–$222,000	$207.90	$59.40
$111,001–$138,000	$222,001–$276,000	$297.00	$148.50
$138,001–$165,000	$276,001–$330,000	$386.10	$237.60
$165,001-$499,999	$330,001-$749,999	$475.20	$326.70
≥$500,000	≥$750,000	$504.90	$356.40
MAGI for Married filing separately			
≤$88,000		$148.50	$0
$88,001-$411,999		$475.20	$326.70
≥$412,000		$504.90	$356.40

Too much investment income in retirement means more tax

The 3.8% Net Investment Income Tax

Filing status	MAGI Threshold amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (HOH) [with qual. person]	$200,000
Qualifying widow(er) with dependent child	$250,000

Dan and Sara need an extra $1,000*

- Combined Social Security benefit of $60,000
- $45,000 IRA income and $15,000 long term capital gain
- In a 12% bracket $1,000 from the IRA = $120 in taxes, but…
  - An additional $850 of Social Security is taxed (+ $102)
  - An additional $1,793 of cap gain taxed at 15% (+ $269)
  - Total tax cost on $1,000 withdrawal (120+102+269) $491
  - Tax cost on the $1,000 was ca. 50% (*and this is just federal tax*)
  - If the $1,000 came from LTCI for an LTC expense there would be no additional tax cost

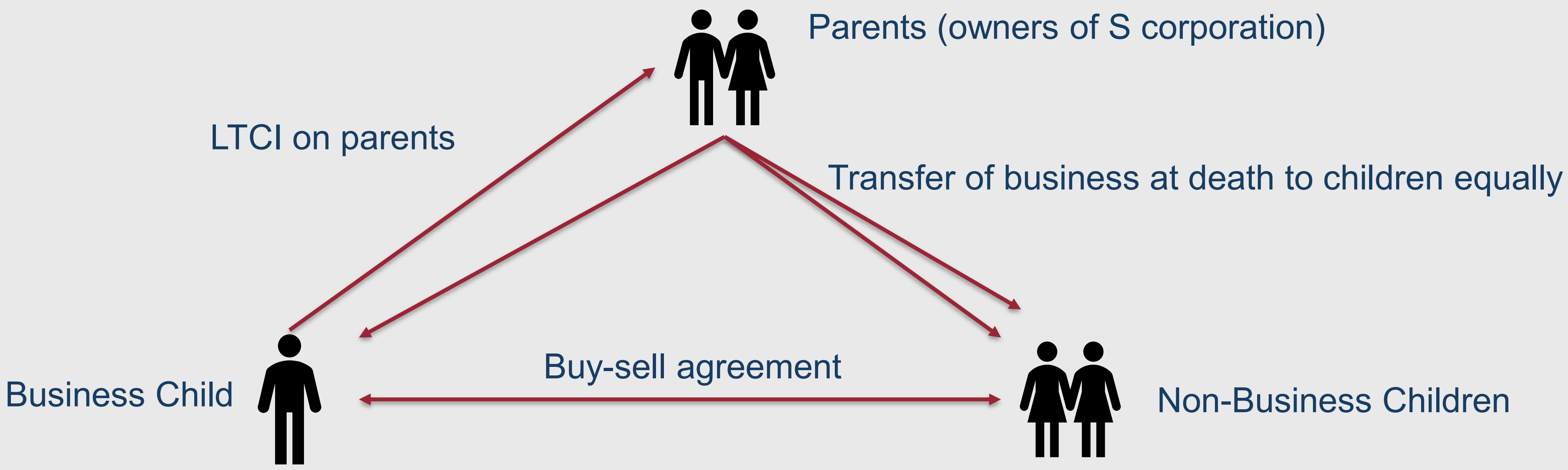
*All numeric examples and all individuals shown are hypothetical and were used for explanatory purposes only

The value of the step-up in basis

- Sale during life
  - Shares bought at $300
  - Shares sell at $800
  - Capital gain $500
- Taxed at 0, 15 or 20 percent
- Each dollar of capital gain is another dollar of AGI

- Heir sells after death
  - Shares bought at $300
  - Shares grow to $800
  - Basis for heir $800
  - Capital gain $0
  - Savings @ 15% $75,000
    (based on 1000 shares)
- Step-up in basis increases the transfer of wealth to the next generation

Transfer of the family business



Filial laws

- Create a statutory duty for adult children to financially support parents who cannot monetarily support themselves
- 30 states have filial laws
  - 21 allow civil court actions
  - 12 impose criminal penalties
  - 3 provide both civil and criminal actions
- The Pittas* case
  - Son ordered to pay $93,000 nursing home bill

*HealthCare & Ret. Corp. of Am. v. Pittas, 2012 PA Super 96, 46 A.3d 719, 723, reargument denied (July 18, 2012), appeal denied, 63 A.3d 1248 (Pa. 2013)

Using trust assets efficiently

- Asset-based LTC protection may be owned by a trust.
  - For analysis we must know the type of trust:
    - Revocable; irrevocable; grantor; non-grantor; living; testamentary; and, what are the dispositive provisions of trust
- The ILIT that's no longer needed (why not?)
- The complex trust seeking to reduce tax exposure
  - The triple win
    - Reduced tax exposure
    - LTC coverage for income beneficiary
    - Tax-free death benefit for remainder beneficiaries

The benefit of asset-based LTC as an employer-provided executive benefit

One product, two issues

Base plus AOB & COB rider

Base life insurance policy + **AOB and COB Riders**

- Treated like any permanent life insurance in the bonus setting
- Deducted by the employer as compensation paid and reported in income by employee as compensation received

- Treated as employer-provided medical coverage
- Treatment depends on relationship between employee and employer

Tax deductibility of qualified LTCI premiums (AOB & COB)

Employees	"Flow-Thru Owners"	Individuals
- Includes C corporation shareholder-employees	- >2% S corporation shareholder-employees, partners, sole proprietors, and LLC members	- Must itemize; subject to 7.5% of AGI floor
- Not limited	- Limited by age-related table	- Limited by age-related table

Other business cases

- Split-dollar arrangements
  - Employer owns
    - Provides death benefit for employee. May have section 105 plan and separate transfer at retirement agreement
- Key man coverage
  - Employer owns
    - Provides death benefit for employer. May have section 105 plan and separate transfer at retirement agreement
- IRC section 401(h) accounts
  - Post-retirement LTC benefits in sub-account of a defined benefit pension plan
- IRC section 412(e)(3) "fully insured" plans
  - Can also have an IRC section 401(h) account

Questions?

Provided content is for overview and informational purposes only and is not intended as tax, legal, fiduciary, or investment advice.