

# Planning Commentary

September 2020

## Planning for the Unimaginable

Long-term care applies to the ongoing care of individuals of all ages who can no longer independently perform basic activities of daily living (ADLs) - such as bathing, dressing, or eating - due to an illness, injury, or cognitive disorder. This care is provided in different places by different caregivers, depending on a person's needs. Most long-term care is provided at home by unpaid family members and friends. It can also be given in a facility such as a nursing home or in the community, for example, in an adult day care center.

Long-term care (LTC) is an issue that touches almost every family at some point. And families may often find themselves ill-prepared for many of the realities and uncertainties that providing care for a loved one can bring.

### COUNTING THE COSTS

If you have any interest at all in Broadway theatre, you are likely familiar with the 2016 Tony-Award winning show, *Hamilton*. This sung-and-rapped-through musical by Lin-Manuel Miranda tells the story of American founding father Alexander Hamilton. During one of the quieter, heart-wrenching songs in the show - "[It's Quiet Uptown](#)" - Miranda describes how Hamilton deals with the "unimaginable" after his son Phillip was killed in a duel with George Eaker in 1801. If you haven't listened to the music - I highly recommended.

While duels are (thankfully) relegated to history, helping clients plan for the "unimaginable" is a big part of the important work we do at Pallas Capital Advisors.

A prolonged health care event may seem unimaginable when you are in your 50's and relatively healthy. However, it is logical: the odds of requiring some sort of long-term care increase as you get older. And as the costs of home care, nursing homes, and assisted living escalate, you probably wonder how you are going to be able to afford long-term care.

The **costs of long-term care** can be overwhelming. Since HMOs, Medicare, and Medigap do not pay for most long-term care expenses, you're going to need to find alternative ways to pay for long-term care.

- The national median cost for home health care today is \$4,195 per month. <sup>1</sup>
- The national median annual cost for a semi-private room in a nursing home is \$89,297. <sup>1</sup>
- The average length of time for any long-term care service needed is 3 years. <sup>2</sup>
- The average out-of-pocket medical costs for a 65-year-old retired couple, excluding LTC, is \$285,000. <sup>3</sup>

1. Genworth Cost of Care Survey 2019, <https://www.genworth.com/aging-and-you/finances/cost-of-care.html>

2. LongTermCare.gov, <https://longtermcare.acl.gov/the-basics/how-much-care-will-you-need.html>

3. Fidelity, "How to Plan for rising healthcare costs", April 2019.



**Medicare** pays very limited benefits for long-term care services (typically about 20 days and only with a prior hospital stay).

**Medicaid** can pay for long-term care services, but you must financially qualify. That means as an individual, you cannot have more than \$2,000 in total assets. In addition, Medicaid is primarily set up to pay for nursing home care – the type of care least desirable in most people’s minds.

**If there is a LTC event, it may impact the entire family – including spouse and adult children:**

- The costs of long-term care (LTC) can be more than financial. Stress on family caregivers, the uncertainty of receiving your preferred care setting, the frustration of wading through Medicare and/or Medicaid requirements—all of these can be alleviated through proper longevity planning.
- Family typically provides the majority of care—if there is not a plan in place, this could cause severe tension among family members.
- Providing long-term care rarely brings families together—it may tear them apart. All siblings may not want nor be able to provide equal assistance.
- Today, families are smaller and geographically dispersed—if adult children move away, who will provide and/or organize care?

**If you have a LTC event, how would you pay for it?**

- Your retirement portfolio has been structured to pay for retirement—not for long-term care expenses.
- An extended LTC event could have a potentially devastating impact on a retirement portfolio. The median annual cost nationally of a semi-private room in a nursing home is \$90,156.<sup>1</sup>
- Medicare does not cover custodial care.
- Medicaid does pay for custodial care, but generally pays for a skilled nursing home. Additionally, you would have to qualify for Medicaid, which is becoming increasingly more difficult.

1. Genworth Cost of Care Survey 2019, <https://www.genworth.com/aging-and-you/finances/cost-of-care.html>

**PREPARING AHEAD**

One solution that should be carefully considered is long-term care insurance (LTCI). There are several good reasons:

- **You’ve seen what happens to people who don’t have it.**
- **You don’t want your family to be forced to take care of you.**
- **You don’t want to spend your life savings on long-term care services.**
- **You want to leave an inheritance for your kids.**
- **You want to be able to stay at home for as long as possible.**

70% of people who reach age 65 will need some long-term care services in their future, however anyone can need long-term care at any time, whether due to illness, accident, or cognitive issues.

**“7 OUT OF 10 AMERICANS WILL NEED SOME TYPE OF LTC DURING THEIR LIFETIMES.”**



**AVERAGE LENGTH OF LTC:**  
3 YEARS

<b>WOMEN:</b> 3.7 YEARS	<b>MEN:</b> 2.2 YEARS
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source: U.S. Department of Health and Human Services



Whether or not you should buy it depends on a number of factors, including your age and financial circumstances. Consider purchasing an LTCI policy if some or all of the following apply:

- You are between the ages of 40 and 84
- You have significant assets that you would like to protect
- You can afford to pay the premiums now and in the future
- You are in good health and are insurable

### WHEN DO LTCI BENEFITS GET PAID?

Whether you have had a LTCI policy for years or you are thinking of buying one, it is critical to understand exactly what set of conditions will trigger coverage. Here are some typical ways you can become eligible for benefits:

- You are unable to perform a certain number of activities of daily living (ADLs) without assistance, such as eating, bathing, dressing, continence, toileting (moving on and off the toilet), and transferring (moving in and out of bed). Look in your policy to see what ADLs are included, the number you must be unable to perform, and how your policy defines “unable to perform” for each ADL, as criteria can vary from one company to another (e.g., does the definition require someone to physically assist with the activity or simply to supervise the activity?).
- Your doctor has ordered specific care.

- Your care is medically necessary.
- Your mental or cognitive function is impaired.
- You have had a prior hospitalization of at least three days (this is rare with newer policies).

A LTCI policy may contain one or more of these provisions. The more specific the language in the provision, the less room for disagreements about coverage.

The best policies let you qualify for benefits if your own doctor orders specific care, rather than require that you be examined by an insurance company physician.

### WHEN WILL BENEFITS START?

Most LTCI policies have a waiting period, commonly known as an elimination period, before you can start receiving benefits after you are judged medically eligible. Common waiting periods are 20, 30, 60, 90, or 100 days.

During any waiting period, you are responsible for paying for your care, whether it is in a nursing home, an assisted-living facility, or in your home. Generally speaking, the longer the waiting period, the less expensive the policy.

### DETERMINING THE BEST LONG-TERM CARE INSURANCE APPROACH

Because everyone’s personal and financial situations are different, there are numerous long-term care policy design options to address your specific needs, preferences, and budgets.

## TRADITIONAL LONG-TERM CARE INSURANCE (LTCI) PRODUCTS

**PROFILE:** You have plenty of income, are less liquid financially, or have no need for life insurance.

#### PROS:

- Comprehensive LTC coverage
- Inflation options
- Asset protection available
- Ability to pay premiums using HSA dollars (age dependent)

#### CONS:

- Ongoing premiums
- Possibility of rate increases
- Chance of no benefits if no LTC need



## LINKED-BENEFIT LTCI PRODUCTS

**PROFILE:** You may want to reposition money from underperforming vehicles (CDs or money market accounts) or existing life insurance cash values.

### PROS:

- Always a payout via death benefit (beneficiaries) LTC benefits, or return of premium option
- Money-back guarantee
- All benefits guaranteed (no possible rate increase)
- Streamlined application process
- Can add inflation options
- Possible partial deduction of premiums with some products

### CONS:

- Small death benefit

## LIFE INSURANCE WITH RIDER LTCI PRODUCTS

**PROFILE:** You have little cash and no extra income. A life insurance policy with built-in living benefit riders may be the least expensive way to include LTCI and insure against premature death.

### PROS:

- Always a payout via death benefit (beneficiaries) or LTC/chronic illness (CI) for self
- Addition of LTC/CI benefits with small premium increase
- Guaranteed payouts
- Premium flexibility – single or ongoing premium

### CONS:

- No inflation options
- No tax deductibility of premiums



## LONG TERM CARE INSURANCE - INCOME TAX CONSIDERATIONS

### Income Tax-Free Benefits:

Long term care policies that are structured to provide qualified long-term care insurance usually provide benefits that are income tax-free, up to certain limits under the tax law. Exceptions may apply that could cause long-term care benefits to be taxable.

For *hybrid* life insurance/LTCI policies – check with the specific carrier. In most cases, the LTC benefits are structured as tax-qualified long-term care agreements that cover care such as nursing care, home and community-based care, and informal care. These agreements provide for the payment of a monthly benefit for qualified long-term care services, and are intended to provide tax qualified long-term care benefits under section 7702B of the Internal Revenue Code.

**In 2020, LTC insurance benefits received on an indemnity (per diem) basis are tax-free to the GREATER OF \$380/day OR your actual expenses paid for care if greater.**

- For example, a LTCI cash benefit payment of \$9,000 per month (\$300/day) is tax free no matter what was spent on care, even if less, since \$300/day is less than the IRS per diem limit.
- If the per diem benefit received is \$400 per day, then \$20 per day (2020) would have to be claimed as taxable income.
- If the per diem benefit received is \$400 per day, but you have \$400 or more per day in paid caregiving charges, then it would all be tax-free.

“Reimbursement” - type LTC policies are generally paid tax-free no matter what the benefit amount is. However, if multiple policies pay for the same charge, then the per diem limit could also apply.

### Premium Deductibility:

#### *Individual Taxpayer:*

Most individual taxpayers will not be able to realize any deduction for long-term care insurance premiums, as you must first be able to itemize deductions on Schedule A, have total un-reimbursed medical expenses including the *LTC Eligible Premium* (see table below) that exceed 10% of your Adjusted Gross Income (AGI), and only the amount above the 10% threshold is deductible.

Below is a table of the amount of Tax Qualified LTC insurance premiums qualifying as an Eligible Medical Expense for the 2019 and 2020 tax years. (These numbers increase each year based on the Medical Consumer Price Index.)

AGE AT END OF TAX YEAR	2019 ELIGIBLE PREMIUM	2020 ELIGIBLE PREMIUM
40 and younger	\$ 420	\$ 430
41 to 50	\$ 790	\$ 810
51 to 60	\$1,580	\$1,630
61 to 70	\$4,220	\$4,350
71 and older	\$5,270	\$5,430



## Health Savings Account Owners:

If you have funds in a Health Savings Account (HSA) - or an employer-funded Health Reimbursement Account (HRA) - you can use those tax-free dollars to pay tax-qualified LTC insurance premiums up to the age-based, Eligible Premium amount shown in the previous table.

## Business Owners (And Spouses):

Business owners get to take the age-based, Eligible Premium deduction "above-the-line" on page one of Form 1040 (line 8a) as part of the "Self Employed Health Insurance Deduction" (Line 16 of Schedule 1). This applies to owners of business incorporated or taxes as: Sole Proprietorships, Partnerships, or Corporations. (Shareholder/Employees of a "regular" C-Corporation can have the entire premium deducted - without limit - if paid as an employee benefit by the corporation.) See the chart below for more information.

**Most "hybrid" or "linked-benefit" policies do NOT qualify for a premium deduction.**

However, if they are "Tax Qualified" any benefits paid for care are tax-free. There may be a reduction in a Hybrid LTC policy's tax "basis" if cash values are withdrawn during life or for the beneficiaries of a LTC-annuity. If a portion of a Hybrid LTC plan's premium qualifies for a deduction (e.g., a separately designated TQ rider), that limited portion follows the guidelines above.

PREMIUM PAYER	SITUATION	DEDUCTIBILITY	PERSONAL TAX BENEFIT
Individual Taxpayer	Individual who itemizes deductions and pays premiums for self and spouse.	Adds eligible premiums to other unreimbursed medical expenses and may deduct amount in excess of 7.5% of AGI. Note the deduction threshold is 10% of AGI for years after 2018.	
All Business Types	Employer pays premiums for non-owner employees and spouses (includes S Corporation employees with a 2% of less ownership interest.	Employer may be able to deduct up to 100% of premiums (if total compensation is "reasonable").	Premiums paid by employer are not included in employee's taxable income.
C Corporation (as well as a LLC taxed as corporation)	Business pays the premium.	100% of premium is deductible (if total compensation is "reasonable").	Premium not considered taxable income; benefits are tax-free.
S Corporation	+Business pays the premium for non-shareholder employees.  +Business pays the premium for shareholder- employee who owns more than 2% interest of S Corp.	100% of premium is deductible  Shareholder- employee may deduct only age eligible premium <sup>1</sup>	Premium not considered taxable income; benefits are tax-free.  Premium included in shareholder-employee's gross income; benefits are tax-free.
Partnerships & LLC's <sup>2</sup>	+Business pays the premium for non-partner employees.  +Business pays the premium for partners or LLC owners.	100% of premium is deductible.  Partner may deduct only age eligible premium. <sup>1</sup>	Premium not considered taxable income; benefits are tax-free.  Premium included in partner's gross income; benefits are tax-free.
Sole Proprietor	Business pays the premium for a sole proprietor.	Sole proprietor may deduct only age eligible premium. <sup>1</sup>	Premium included in sole proprietor's gross income; benefits are tax-free.

1. The amount of premium treated as a medical expense as defined in Section 213(d)(1) and Section 213(d)(10) of the Internal Revenue Code. Eligible premiums are based on age and are adjusted for inflation annually. Section 162(l) provides special rules for deductibility of health insurance premiums for self-employed individuals on Form 1040 U.S. Income Tax return. See table on page 5.

2. LLC owners are considered to be partners for income tax purposes under the Internal Revenue Code.



## CONCLUSION

Elizabeth Schulyer Hamilton outlived her husband Alexander by fifty years and died in 1854 at the age of 97. With advances in health care, people today are living longer than ever before. No one looks forward to needing long-term care, in fact when you are healthy, it may seem “unimaginable.” But the facts show that it is important to plan ahead nonetheless.

Like other types of insurance, long-term care insurance protects you against a specific financial risk -in this case, the chance that long-term care will cost more than you can afford. In exchange for your premium payments, the insurance company promises to cover part of your future long-term care costs. Long-term care insurance can help you preserve your assets and guarantee that you and your family will have access to a range of care options.

At Pallas, we help you prepare ahead of time for the unexpected. So, if the unimaginable happens, you will be prepared.



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