A More Practical Way for the Affluent to Self Insure Long Term Care

Using Indemnity-style Linked Benefit LTC Coverage in a Trust

Shawn Britt, CLU
Director, Advanced Consulting Group
Nationwide Financial

Estate Planning and Long Term Care

When it comes to long-term care (LTC), many affluent people feel they can afford to self insure the LTC risk. But is self insuring the most efficient use of their assets? After all, one important goal in estate planning is preserving wealth - and LTC expenses can put a large dent in an estate when not properly planned for.

The downside for the affluent self-insuring LTC

Self insuring LTC in a typical fashion may not be the best solution for many affluent people. In order for the client to self insure, in practicality it helps to have assets available that are liquid and accessible inside their estate in the event they encounter a LTC situation. Let's assume this client sets aside $1,000,000 for this purpose. If the client actually needs LTC and spends through most or all of the $1,000,000, then the "self insure" plan worked well enough. However, if the client needs little or none of the assets set aside for LTC services, and assuming a 2014 estate tax rate of 40%, taxation of the $1,000,000 could result in a tax bill of up to $400,000. But there is a potential way to avoid this pitfall by insuring the long-term care risk with an indemnity- style linked benefit LTC policy owned by an Irrevocable Life Insurance Trust (ILIT).

What is Linked Benefit LTC Coverage?

Simply put, an asset is re-positioned to be leveraged for LTC coverage on a policy linked to life insurance. The primary purpose is insuring LTC, and that is where the full leverage amount will be. But there is also a death benefit on the policy, which assures cost recovery should the policy be little or never used (assuming no withdrawals or loans). In addition, the return of premium feature included with the policy keeps the asset on the client's net worth statement. While most of these policies are paid with a single premium, there are premium schedules available up to 10 years.

Why Indemnity?

Only an indemnity-style LTC benefit can work within a trust because the LTC benefit is sent directly to the owner of the contract, which in the case of trust ownership would be the trust/trustee. The insurance policy is essentially funding the trust with cash via payment of an accelerated death benefit. There is no reimbursement of actual LTC expenses on behalf of the insured. It is important to note the insured (grantor) must never have the LTC benefit directly in hand nor can they have claims against the trust for such monies.

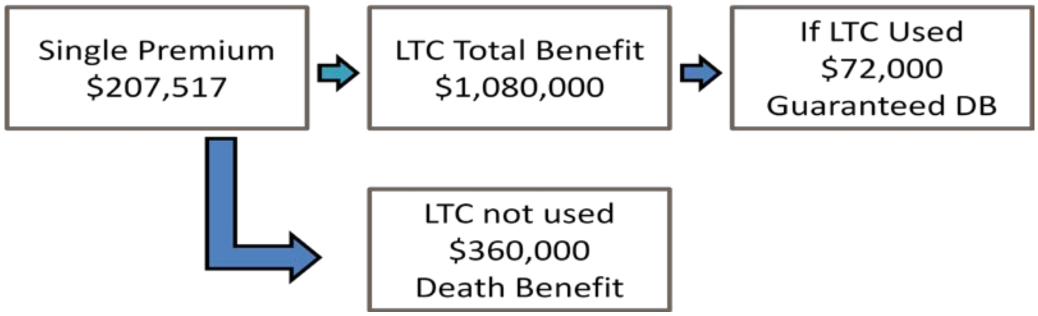
Using the ILIT to Help Efficiently Fund Long-term Care Needs
An Ultimate Life Insurance Trust (ULIT) may be appropriate for clients who don't want to lose total control of trust assets, fearing they may need funds in the future. A ULIT is a type of Irrevocable Life Insurance Trust (ILIT) that may allow the Grantor/Insured or Grantor/Insured's spouse access to trust assets.

The trust is written to allow for arms length fully collateralized loan provisions. The loan is secured by property pledged by the Grantor/Insured. The loan must be legitimate with collateral pledged, interest charged, and an agreement to fully pay back the debt. Collateral can be anything that covers the debt; a house, artwork, coin collections, etc. The interest rate charged should be at least equal to the interest charged on the life insurance policy (although in this concept there will be no loan taken again the policy itself, this is good fiduciary practice). Keep in mind, the higher the interest is, the better this concept works, but it still must remain reasonable. In most cases, the loan interest is allowed to accrue. Ideally, the loan interest should be paid back prior to the death of the Grantor/Insured to avoid taxation as income to the trust. Some plans set up interest to be paid on a periodic basis to hedge against the risk of all interest being taxable at death, though this will impact the accrual of the debt (which in this case is an advantage as you will shortly see). Principal can be paid back after death with no tax liability.

The Process of taking the Collateralized Loans
When using a ULIT type ILIT for the purposes of getting long-term care rider benefits from the trust you may do the following:

- File a claim for the LTC benefit
- After 90 day elimination period, a monthly check will be sent to the trust (as contract owner)
- The grantor then borrows money from the trust upon pledging property as collateral
- These funds can be used to pay LTC bills
- Interest is allowed to accrue to purposely increase the debt – but ideally is paid back just prior to death to avoid taxation
- At the grantors death, the loan principal and any unpaid interest is paid to the trust, then is deducted from the estate assets for taxation purposes leaving a smaller estate tax liability.

Doing the Math-the numbers
Our hypothetical example will assume our client is a 55 year old female non-smoker, and qualified for a couple rate. She will gift $207,517 to her trust by using part of her lifetime exemption. The trust will purchase, own and be the beneficiary of an indemnity style linked benefit LTC policy that provides a six year benefit of $1,080,000 in total LTC benefits. There is a guaranteed death benefit of $360,000 if LTC is never needed and a guaranteed minimum death benefit of $72,000 if LTC is needed. The monthly LTC benefit amount paid to the trust will be $15,000 per month. The trust will include loan provisions needed for this concept using an 8% interest rate.



Upon going on LTC claim, the grantor borrows funds from the trust over a 6 year period of time equaling $1,080,000. It may be wise to borrow funds in a manner that doesn't align exactly with the payment of LTC benefits to the trust. Please consult an attorney for proper lending process within the ULIT. Interest on this loan will accrue to a total of $309,582. At grantor's death, the minimum death benefit is paid to the trust equaling $72,000.

The Results

The principal can be repaid after death with no tax consequences. However, if the loan interest is repaid just prior to death, the $309,582 interest payment is moved from the estate to the trust and is spared from estate taxes, (and possible income taxes) saving the beneficiaries **$123,833**. In addition, when you add the death benefit of **$72,000** to the $123,833 in tax savings, the beneficiaries net an extra **$195,833**. The cost of the policy was **$207,517.** The policy paid out $1,080,000 in LTC benefits – borrowed from, now repaid to and residing tax free in the trust for the beneficiaries. Thus, the potential net cost of purchasing a policy paying a net amount of $1,080,000 for LTC benefits and helping to protect the inheritance to the beneficiaries by the same amount was only **$11,684.**

Upon Death After a 6 Year Claim		
Estate	**Trust**	**Net Policy Cost**
Repays principal borrowed $1,080,000 →	Repaid principal $1,080,000	Single premium paid $207,517
Repays loan interest just prior to death $309,582 →	Repaid loan interest not subject to estate tax $309,582 →	Minus tax savings from interest moving from estate into trust -$123,832 (40% tax rate)
The above funds are now removed from the estate	Guaranteed Death Benefit $72,000 →	Minus Guaranteed Death Benefit -$72,000
	Total in Trust **$1,461,582**	**Net Policy Cost** **$11,684**

While every situation is different, and must be individually considered, a financial advisor may want to consider to effective use of an indemnity Linked Benefit policy to enhance the amount of inheritance a client could potentially leave to loved ones.

The LTC rider is offered at an additional charge. It is possible for the LTC rider to be offered on a rated basis, which may increase the premium illustrated. Also keep in mind that as an acceleration of the death benefit, the LTC rider payout will reduce both the death benefit and cash surrender values. Care should be taken to make sure that your clients' life insurance needs continue to be met even if the rider pays out in full. There is no guarantee that the rider will cover the entire cost for all of the insured's long-term care as these vary with the needs of each insured. Inflation protection is not available, so the policy amount purchased today may not provide adequate funds for LTC expenses in the future.

Please note that as your clients' personal situations change (i.e., marriage, birth of a child or job promotion), so will their life insurance needs. Care should be taken to ensure these strategies and products are suitable for long-term life insurance needs. You should weigh your clients' objectives, time horizon and risk tolerance as well as any associated costs before investing. Also, be aware that market volatility can lead to the possibility of the need for additional premium in the policy.

Not all Nationwide products and services are suitable for all clients or situations. There may be products, issued by other companies, which better suit your clients' goals. Be sure to consider your clients' objectives, their need for cash flow and liquidity, and overall risk tolerance when using any strategy. The information in this material is for illustrative purposes only and is not intended as investment advice to you or your clients. You are solely responsible for determining the suitability of advice or recommendations you develop for your clients, including strategies that incorporate concepts or information presented in this material.

This information was developed to promote and support products and services offered by Nationwide. It should not be taken as tax advice. It was not written or meant to be used by any taxpayer to avoid tax penalties, and it cannot be used by any taxpayer for that purpose. Federal tax laws are complex and subject to change. This information is based on current interpretations of the law. Neither the company nor its representatives give legal or tax advice. Please talk with your attorney or tax advisor for answers to your specific questions.

Federal income tax laws are complex and subject to change. The information in this memorandum is based on current interpretations of the law and is not guaranteed. Neither Nationwide, nor its employees, its agents, brokers or registered representatives gives legal or tax advice. You should consult an attorney or competent tax professional for answers to specific tax questions as they apply to your situation.

Nationwide®
On Your Side

Nationwide and the Nationwide framemark are registered service marks of Nationwide Mutual Insurance Company©. Nationwide Financial Services, Inc. All rights reserved. Nationwide Investment Services Corporation, Columbus, Ohio, member FINRA. Life insurance is issued by Nationwide Life Insurance Company or Nationwide Life and Annuity Insurance Company, Columbus, Ohio, member of Nationwide Financial®.

NFM-12639AO *(02/14)*