FINANCIAL JOURNEYS

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Funding long-term care with an irrevocable life insurance trust

How this strategy can help you avoid unnecessary taxation and create generational wealth.

No one wants to assume they'll need long-term care, but being prepared may give you – and your loved ones – peace of mind. For some, that means finding comfort in purchasing long-term care insurance to help cover medical and non-medical expenses as they age.

Those who have the resources to self-fund long-term care may not consider buying a long-term care policy. However, purchasing one and placing it inside an irrevocable life insurance trust can have benefits beyond the policy itself.

AVOIDING UNNECESSARY TAXATION

Setting aside money for long-term care expenses and using all or most of the funds may serve as proof that self-funding was successful. But, if little or none of the savings set aside was used, the funds earmarked for long-term care could result in a significant estate tax when it comes time to pass assets to the next generation.

To avoid this situation, individuals can purchase a linked-benefit long-term care policy that pays indemnity benefits and place it in an irrevocable life insurance trust. A linked-benefit policy in this case refers to one policy that combines long-term care insurance and life insurance. The death benefit ensures that the premium paid for the policy is protected from loss if the policy is rarely or never used.

HOW IT WORKS

A carefully designed trust allows the insured to indirectly access funds by borrowing from the trust to pay for long-term care. The trust must be written with provisions for fully collateralized loans. The loan has to be legitimate, secured by property pledged by the insured individual, with interest charged and an agreement to fully pay back the debt.

If the insured needs long-term care, the trustee would file a claim for the long-term care benefit. After it's approved, monthly benefit payments are sent to the trust. The individual who needs care borrows funds from the trust upon pledging proper collateral and these funds can be used to pay long-term care expenses without any restrictions.

Funding long-term care with an irrevocable life insurance trust (cont.)

Upon death of the insured, the loan principal and any unpaid interest is repaid to the trust. That amount is deducted from the calculation of assets subject to estate taxes.

The higher the interest rate (within reason), the better this concept works. Interest is allowed to accrue to intentionally increase debt. Interest must be paid back prior to the insured's death to avoid income taxation to the trust. Upon the death of the insured, the loan principal and unpaid interest would be repaid to the trust. And that same amount would be deducted from estate assets for the purpose of taxation, leaving a smaller estate tax liability.

A CASE STUDY

Bill uses part of his lifetime exemption to gift $196,032 to an irrevocable life insurance trust. The trust will purchase, own and be the beneficiary of a linked-benefit long-term care policy that pays indemnity benefits and provides a 6-year benefit pool of $1,080,000 in total benefits. The trust will include the loan provisions needed for this concept using an 8% interest rate.

If Bill needs long-term care, he will borrow $1,080,000 from the trust over a 6-year period. If the $308,582 interest accrued is repaid prior to Bill's death, it will be spared from estate and possibly income tax, saving $123,833. Upon Bill's death, the guaranteed minimum benefit of $72,000 is paid to the trust. The estate will repay the loan principal, incurring no tax consequences. The net cost of the policy ends up being $199.

If Bill never needs long-term care, the trust receives a tax-free death benefit of $360,000 and he doesn't subject himself to the unnecessary estate taxation that self-funding could cause, saving up to $400,000 (assuming a 40% tax rate). Even considering the $196,032 he paid for the policy, the additional $563,968 can be left to heirs.

Everyone's wishes for long-term care and how they plan to fund it will differ, but this strategy may help you avoid unnecessary taxation and result in additional inheritance for your heirs when compared to self-funding. ■

This hypothetical example is for illustrative purposes only and is not representative of any actual client experience. Individual results will vary.

Guarantees are based on the claims paying ability of the issuing company. Long Term Care Insurance or Asset Based Long Term Care Insurance Products may not be suitable for all investors. Surrender charges may apply for early withdrawals and, if made prior to age 59 ½, may be subject to a 10% federal tax penalty in addition to any gains being taxed as ordinary income. Please consult with a licensed financial professional when considering your insurance options.

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Is organic worth the cost?

When buying produce, consider the 'clean fifteen' versus the 'dirty dozen.'

You may have heard of the "dirty dozen" – produce that's high in pesticides and may lead people to choose organic options. But buying organic can add up, so which produce is worth the extra cost? Consider the "clean fifteen," – a list of produce that's typically low in pesticides due to natural protective barriers like thick or inedible skins.

In order of least pesticide residue, these fruits and vegetables may not be worth the markup you'd pay for organic:

1. AVOCADOS
2. SWEET CORN
3. PINEAPPLES
4. ONIONS
5. PAPAYAS
6. FROZEN SWEET PEAS
7. ASPARAGUS
8. HONEYDEW MELONS
9. KIWIS
10. CABBAGE
11. MUSHROOMS
12. MANGOES
13. SWEET POTATOES
14. WATERMELONS
15. CARROTS

The impact of donating appreciated stock

Giving appreciated stock can be a gift for both you and your favorite charity.

For many people, the end of the year brings about a time for reflection and a renewed sense of purpose. We tend to get together with family and friends and focus on what matters most. If generosity is in your heart, this might mean thinking about how you can make a greater impact on your favorite charities.

Donating long-term appreciated securities may not only serve its purpose of supporting causes you care about but also help you realign your portfolio and donate in a tax-efficient way. Learn more about how this strategy not only benefits the nonprofits you love, but how it can be used as a wealth management tool.

A GIFT FOR THEM, A (TAX) BREAK FOR YOU

Donating appreciated stock offers several benefits, most notably, the ability to make a larger value donation than giving cash after liquidating. You can avoid capital gains tax on the appreciated amount that you would have incurred had you sold the stock, and you get a tax deduction for the full fair market value of your long-term capital gain asset – up to 30% of your adjusted gross income. It can be a win-win for those planning to donate to their favorite cause.

Another benefit? At the end of the year, it's common practice to rebalance your portfolio. If you're considering donating appreciated stock, you can do so strategically to reduce a concentrated equity position and help bring your portfolio back in line with your goals.

If you decide to donate a stock as an alternative to gifting cash, you can repurchase identical shares, often resulting in a step up in cost basis.

GIFTING STOCK TO A DONOR ADVISED FUND (DAF)

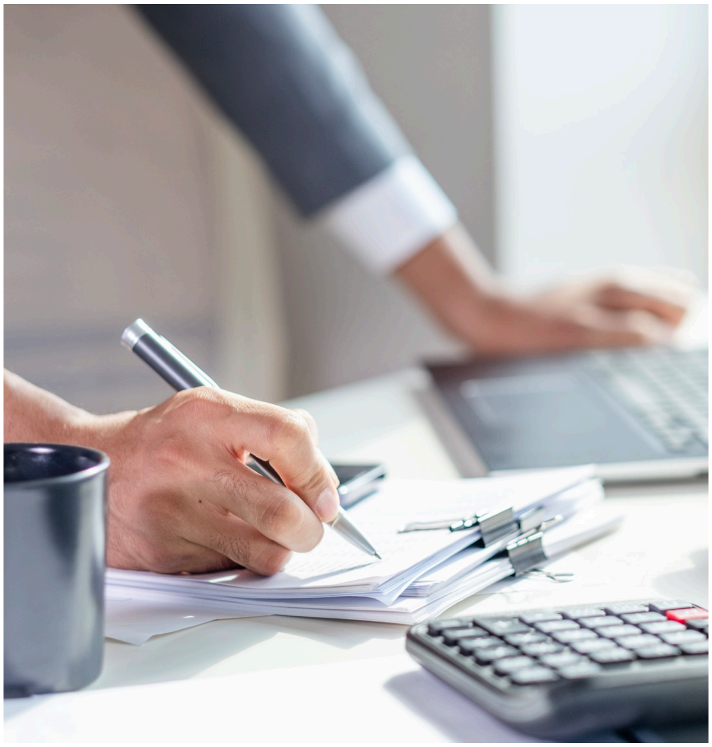
The ability to donate your appreciated stock to a DAF adds a potential benefit: the opportunity to grow your donation, tax-free. Donors use DAFs as a tool to enhance their charitable giving. The fund (a charity in and of itself) distributes the contributions to approved 501(c)(3) organizations that you select when you're ready. You don't have to gift the funds right away either. You can invest them and let them grow for as long as you wish.

Additional benefits of DAFs include the ability to contribute to the fund and claim the accompanying tax deduction when it works best for you and your financial plan. It also offers an opportunity to get multiple generations involved in your philanthropic endeavors by asking for recommendations for charitable organizations to fund and designating individuals as successor advisors to ensure your legacy of giving continues.

A bunching strategy can also work particularly well with DAFs. If you're charitably inclined but don't have sufficient itemized deductions to exceed the standard deduction, you may decide to bunch donations by making a large charitable gift during a single year, equal to the total donation you would have made over several years. This can help you take advantage of itemizing in the year of your large donation, while taking the standard deduction in future years.

There are several factors to take into account when deciding how best to share your wealth with the causes closest to your heart. Donating appreciated stock may be one of the strategies to consider, especially as you look to the end of the year and seek to rebalance your portfolio. ■

The process of rebalancing may result in tax consequences. Donors are urged to consult their attorneys, accountants or tax advisors with respect to questions relating to the deductibility of various types of contributions to a donor advised fund for federal and state tax purposes. To learn more about the potential risks and benefits of donor advised funds, please contact your financial advisor.



Sources: cbpp.org, asppa.org