**MARC GLICKMAN,**

*FSA, MAAA, LTCP, is vice president of investments and business development at LifeCare Assurance. His responsibilities include growing LifeCare's financial partnerships, reviewing product experience, and pricing and investment strategy. He has ten years of experience in the actuarial field and earned a BA in economics from Yale University.*

*Prior to joining LifeCare, Glickman assisted Fortune 500 companies with their benefits programs as compensation consultant and pension actuarial analyst for Watson Wyatt.*

*Glickman can be reached at LifeCare Assurance Company, 21600 Oxnard St., Suite 1500, Woodland Hills, CA 91367. Telephone:* ***818-867-2296****. Email:* ***Marc.Glickman@LifeCareAssurance.com****.*

# Carving Out A Long Term Care Insurance Plan

This is part two of the series on designing affordable LTCI plans using new visualization tools. Part One *Visualizing a Long Term Care Insurance Plan* appeared in the August 2017 issue of Broker World.

In part one of the series we discussed LTCI 2.0 – A reboot of LTCI plans designed to mitigate the escalating risk for long term care costs. Let's run down the list of LTCI objections and recently available solutions shown in table 1:

These last two solutions, Executive Carve Outs and 1035 Exchanges, represent the biggest opportunities in many years to reinvigorate the LTCI market. In this article, I will dive into Executive Carve Outs with new visually interactive tools. I will cover 1035 Exchanges in the next article as part three of this series.

The majority of LTCI planning today occurs between the ages of 45 and 65 as individuals begin to think about their retirement needs. Many have personally experienced caregiving challenges, financing strains, and emotional fatigue from providing long term care for their parents. Most are still in good health. Often, they have just finished raising their own children and paying for family obligations. It is time for them to focus on their own retirement plans. Now is the perfect time to begin the long term care planning conversation.

The children who step forward to plan for the care of the parents are oftentimes successful business people. They have often funded their own qualified investment vehicles such as 401(k) plans to the maximum levels. LTCI is the perfect complement to protect these retirement assets. The risk conversation about outliving wealth has become more relevant in recent years as we have seen a generational change in retirement plans from defined benefit to defined contribution, which shifts longevity risk from corporations to individuals.

Fortunately, the IRS tax code can come to the rescue. Owing to an underutilized section of the tax code,[1] business owners can deduct LTCI premiums as a business expense and still receive their LTCI benefits tax-free. This is unique to the LTCI plan, which is classified as health insurance. This means LTCI enjoys the same benefits for business owners as medical insurance when it is purchased through the business. Unlike disability income insurance, virtually all LTCI policies also enjoy special tax-qualified status, where benefits are generally received

**Table 1: LTCI 2.0 Solutions Address Legacy Concerns**

| Objection | Solution |
|---|---|
| Too expensive | Plans with significant benefits for as little as $15/ month |
| May become too expensive (i.e. fear of rate increase) | LTCI 2.0 pricing is more stable<br>Guaranteed single pay, 10-pay, and return of premium options |
| Need can be self-insured | Tax-free benefits, lifetime benefit option, substantial premium leverage, and no liquidation costs, makes LTCI obvious for any client |
| Only for the healthiest | Using the LTCI "family" of plans based on the client's health provides more alternatives. From healthiest to least: Traditional LTCI, life insurance with LTC riders, chronic illness riders, short term care insurance, and substandard annuities |
| Use it or lose it | Return of premium or asset based LTCI eliminates this fear |
| Significant cash outlay | Paying premiums with different sources of funds:<br>• Using the corporate checkbook to provide LTCI coverage as a tax deductible business expense or;<br>• Utilizing existing life or annuity cash values through tax-free 1035 Exchanges |

tax-free.[2]

The opportunity originated from HIPAA in 1996, which clarified the definition and treatment of tax-qualified LTCI. For C-Corporations, the IRS allows full deductibility of LTCI premiums. This means that nearly two million C-Corps can offer LTCI plans to their owners, key executives, and employees without limitations on the deductibility. LTCI plans are allowed to be offered selectively to any or all employees in the organization and their spouses or dependents. Often times, C-Corps will begin by offering these plans just to the owners or key executives. In later years, after observing the value, they roll it out to all employees.

There is an even bigger and mostly unrecognized opportunity that has emerged over the last few years. The 25-30 million small businesses in the U.S., including S-Corporations, Partnerships, and Sole Proprietors can benefit from similar unique tax advantages. This includes small family owned businesses, or professional businesses that doctors, lawyers, or accountants, organize to limit personal liability exposure. The main difference between C-Corporations and these pass-through entities[3] is the deduction is limited annually to the below table in IRC section 213

Today's tax deductibility under these age based limits is much greater than ever before. This is because the IRS increases these limits annually, based on the health-care CPI index. On average, the annual increase has been around three percent, but in 2017 the limit increased by five percent.

**IRC Section 213: Age Eligible Limits**

| Age | 2017 Limit Per Insured |
|---|---|
| 40 | $ 410 |
| 41-50 | $ 770 |
| 51-60 | $1,530 |
| 61-70 | $4,090 |
| 71+ | $5,110 |

The cumulative effect of 20 years worth of these increases has made small business tax deductibility for LTCI premium more than double its original levels. Simultaneously, the average LTCI premium purchased has stayed relatively constant. This seems surprising to many of those who are not immersed in LTCI sales, yet it is intuitive once you consider that the average purchase today covers three to five year benefit periods instead of lifetime and three percent compound inflation protection instead of five percent.

Let's revisit the sample age 50 couple from part one of this series. The two individuals were able to purchase significant LTCI coverage, composed of a combined $742,998 of asset protection with return of premium upon death and an 80 percent cash surrender option. The cost was only $1,589 per year for both of them combined. Over the life of the policy, maximum tax-free benefits received were up to 15.6 times the paid premium if both individuals qualified as chronically ill after satisfying their 90-day deductible periods. If the couple did not use their LTCI, they received their premiums back as a return of premium death benefit.

Now let's assume that the wife is the owner of her small business. She is informed by her insurance advisor that both her and her spouse's LTCI can be purchased as a tax-deductible business expense just like her health insurance. Also, her insurance coverage will be fully paid-up before she retires by using the 10-pay premium option. If we use the same sample LTCI benefit structure, substitute 10-pay for lifetime pay, and remove the return of premium option, the cost of the plan would be $2,668, now paid only over ten years. Under the new plan design, the couple pre-tax has maximum benefits of up to 27.9 times their cost as shown on the left-side of the graphic (on page 28).

If we assume that the couple's individual tax rate is 35 percent, they can effectively save an additional 33.5 percent by paying their LTCI premiums using the corporate checkbook! The couple receives the value of up to a total of $742,998 of LTCI benefits with an after-tax cost of only $17,736 as shown on the right-side of the graphic. This results in maximum benefits of up to 41.9 times after-tax. In summary, all except for $1,128 of their premiums may be deducted as a business expense.

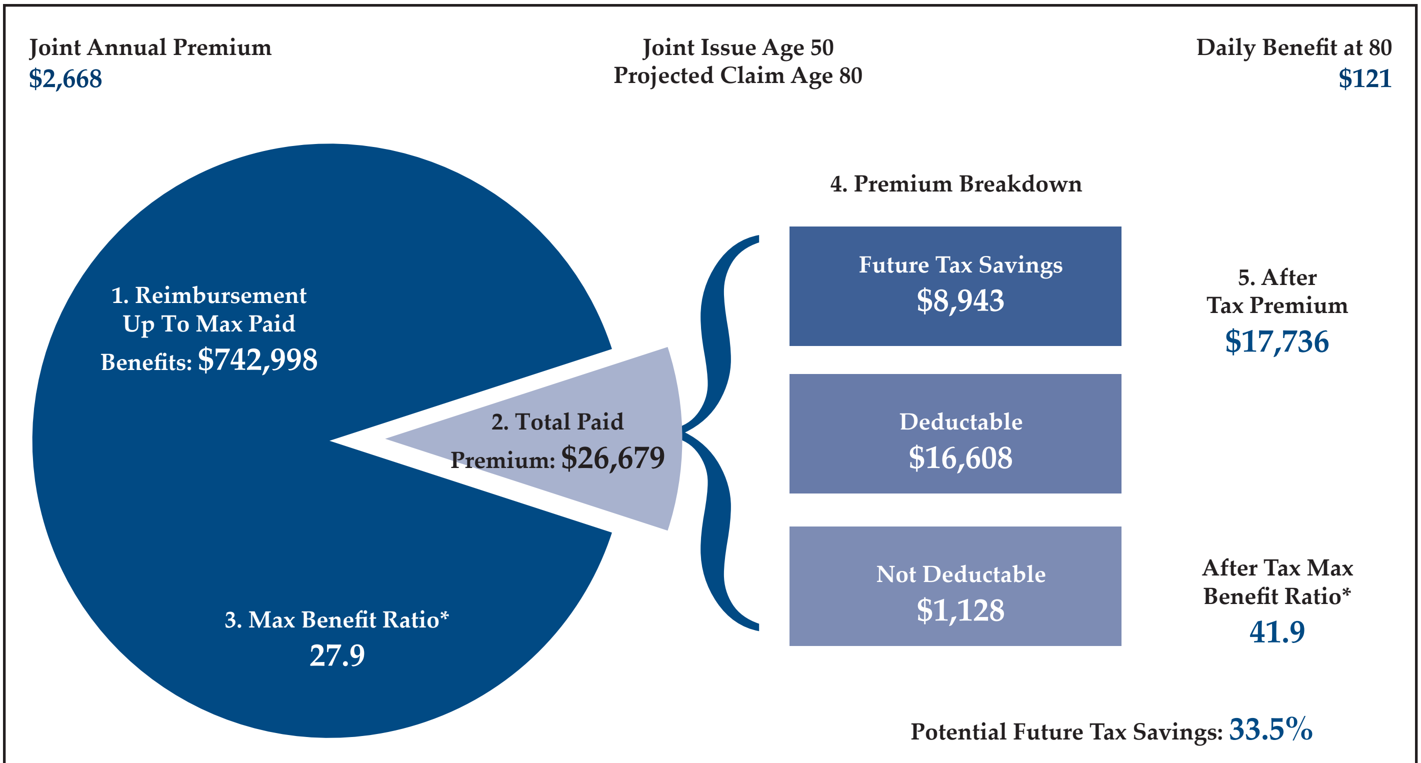
Details for this example projected each calendar year are shown below, where the couple deducts the premiums on their joint tax return as a self-employed health insurance deduction (line 29 of the 1040) up to the age eligible limits. The couple is able to deduct $770 per person or $1,540 in calendar year 2017. They can deduct up to $1,530 per person and the full $2,668 in calendar 2018 and beyond.

An even bigger opportunity is available for business owners as they edge closer to retirement, because they are now allowed to deduct up to $4,090 per person upon reaching age 61. This means they can purchase a policy with over three times as much coverage as the illustrated policy starting at age 61, and still receive the majority of the tax savings. It is difficult to picture a situation where a business owner would choose to self-insure instead of buying LTCI coverage, especially when you project future increases to the IRC section 213 limits.

It is important to distinguish the difference in tax treatment for a small business owner compared to an individual taxpayer. IRC 213 deductions are available on the first dollar of premium for a small business owner as an above the line self-employed deduction. This compares to an individual who would be required to itemize the deduction as a medical expense, which must exceed 10 percent of the taxpayer's Adjusted Gross Income (AGI) before any is allowed. Even this limited deduction will be minimized if their income is too high or if they fall into the alternative minimum tax bracket.

Keep in mind that customized plan design based on the client's target budget and needs is the first priority. Paying with the corporate checkbook adds another incentive. The significant extra tax savings is the secret sauce that will encourage the client to finalize their LTC planning this year, so they can begin enjoying the deductibility.

The majority of trusted agents and advisors are unaware that this opportunity exists. The first time they hear about it is a magical aha moment. Just the solution that they have been looking for to protect against the risk that is front of mind. If you can partner with these planning experts, whether they are financial advisors, CPAs, employee benefits advisors, estate




1. Maximum benefits from the plan if used in full
2. Total cost of the plan
3. Key value metric = total maximum benefits divided by total cost
4. Deductible portion of the total premium
5. After-tax cost

planners, tax attorneys, or life/health/P&C agents, this big idea can become a major part of your practice. In fact, you will often find that your first "clients" will be the self-employed independent agents or advisors themselves. Which begs the question, have you considered **your** long term care plan?


***References***

*1. US Code 7702B: https://www.law.cornell.edu/uscode/text/26/7702B. IRC Section 105: https://www.law.cornell.edu/uscode/text/26/105. IRC Section 106: https://www.law.cornell.edu/uscode/text/26/106. IRC Section 162: https://www.law.cornell.edu/uscode/text/26/162. IRC Section 213: https://www.law.cornell.edu/uscode/text/26/213*

*2. Always consult your client's tax advisor because every tax situation is unique. State and local tax rules may differ.*

*3. Less than 2% owners of an S-Corp receive the full deductibility of a C-Corp*


| Self-Employed | | | |
|---|---|---|---|
| Calendar Year | Ages | Self Employed Deduction | Potential Tax Savings |
| 2017 | 50/50 | $1,540 | $539 |
| 2018 | 51/51 | $2,668 | $934 |
| 2019 | 52/52 | $2,668 | $934 |
| 2020 | 53/53 | $2,668 | $934 |
| 2021 | 54/54 | $2,668 | $934 |
| 2022 | 55/55 | $2,668 | $934 |
| 2023 | 56/56 | $2,668 | $934 |
| 2024 | 57/57 | $2,668 | $934 |
| 2025 | 58/58 | $2,668 | $934 |
| 2026 | 59/59 | $2,668 | $934 |
| | **Total** | **$25,551** | **$8,943** |