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Funding long-term care expenses: What are your options?

Few things can derail your estate plan as quickly as unanticipated long-term care (LTC) expenses. Most people will need some form of LTC — such as a nursing home or assisted living facility stay — at some point in their lives. And the cost of this care is steep. According to a 2021 survey by Genworth, the national median cost of a private room in a nursing home is about $9,000 per month. For assisted living facilities, the median cost for a one-month stay is about $4,500, while home health aides cost more than $5,000 per month.

Contrary to popular belief, LTC expenses generally aren't covered by traditional health insurance policies, Social Security or Medicare. So, to help ensure that LTC expenses don't deplete savings or other assets meant to go to your heirs, have a plan for funding them. Here are some of your options.

Self-Funding

If your nest egg is large enough, it may be possible to pay for LTC expenses out-of-pocket as (or if) they're incurred. An advantage of this approach is that you'll avoid the high cost of LTC insurance premiums. In addition, if you're fortunate enough to avoid the need for LTC, you'll enjoy a savings

windfall that you can use for yourself or your family. The risk, of course, is that your LTC expenses will be significantly larger than anticipated, eroding the funds available to your heirs.

Any type of asset or investment can be used to self-fund LTC expenses, including savings accounts, pension or other retirement funds, stocks, bonds, mutual funds, or annuities. Another option is to tap the equity in your home by selling it, taking out a home equity loan or line of credit, or obtaining a reverse mortgage.

LTC insurance policies cover LTC services that traditional health insurance policies typically don't cover.

Two vehicles that are particularly effective for funding LTC expenses are Roth IRAs and Health Savings Accounts (HSAs). Roth IRAs aren't subject to minimum distribution requirements, so you can let the funds grow tax-free until they're needed. And an HSA, coupled with a high-deductible health insurance plan, allows you to invest pretax dollars that can be withdrawn tax-free to pay for qualified unreimbursed medical expenses, including LTC. Unused funds may be carried over from year to year, making an HSA a powerful savings vehicle.

LTC insurance

LTC insurance policies — which are expensive — cover LTC services that traditional health insurance policies typically don't cover. Determining when to purchase such a policy can be a challenge. The younger you are, the lower the premiums, but you'll be paying for insurance coverage during a time that you're not likely to need it.

Tax benefits for long-term care

Covering long-term care (LTC) costs is expensive, whether you self-fund or purchase LTC insurance. Fortunately, there are tax benefits available that can help offset some of the expense. If you self-fund the cost of your LTC, your out-of-pocket expenses generally will be deductible as medical expenses, provided you itemize deductions on your tax return. Medical expenses are deductible to the extent that they exceed 7.5% of your adjusted gross income (AGI).

If you purchase LTC insurance, any benefits you receive will not be taxable. In addition, if the policy is "tax qualified," you'll be entitled to deduct a portion of your premiums. Currently, deduction limits range from $480 per year for taxpayers age 40 or younger and up to $5,960 per year if you're over 70. A tax-qualified policy is one that's guaranteed renewable and noncancelable regardless of health, doesn't condition eligibility on prior hospitalization, doesn't exclude coverage based on a diagnosis of Alzheimer's disease or dementia, and meets certain other requirements.

Keep in mind that LTC premiums are treated as medical expenses, which are deductible only to the extent they total more than 7.5% of your AGI and only if you itemize. Also, be aware that tax-qualified policies may have higher premiums and stricter eligibility requirements than nonqualified policies, so weigh the advantages of tax deductibility against the potential disadvantages of a qualified policy.

Although the right time for you depends on your health, family medical history and other factors, many people purchase these policies in their early to mid-60s. Keep in mind that once you reach your mid-70s, LTC coverage may no longer be available to you.

In evaluating LTC insurance, be sure to find out whether your employer offers a less costly group LTC policy. Also, consider whether tax benefits are available to offset some of the cost. (See "Tax benefits for long-term care" above.)

Hybrid insurance

Hybrid policies combine LTC coverage with traditional life insurance. Often, these take the form of a permanent life insurance policy with an LTC rider that provides for tax-free accelerated death benefits in the event of certain diagnoses or medical conditions.

These policies can have advantages over stand-alone LTC policies, such as less stringent underwriting requirements and guaranteed premiums that won't increase over time. The downside, of course, is that to the extent you use the LTC benefits, the death benefit available to your heirs will be reduced.

Life insurance exchanges or settlements

If you have a permanent life insurance policy, it may be possible to do a tax-free exchange for a traditional or hybrid LTC policy. Alternatively, it may be possible to do a "life settlement," in which you sell a permanent or term life insurance policy for its current value and use the proceeds to fund LTC expenses.

Weigh your options

There are several potential strategies for funding LTC expenses. Work with your professional advisor to review your financial and health circumstances, weigh your options, and develop a plan that meets your needs. ■

Influencing your heirs

4 tips for an effective incentive trust

Estate planning isn't just about sharing wealth with the younger generation. For many people, it's equally important to share one's values and to encourage their children or other heirs to lead responsible, productive and fulfilling lives. One tool for achieving this goal is an incentive trust, which conditions distributions on certain behaviors or achievements that you wish to inspire.

Incentive trusts can be effective, but plan and draft them carefully to avoid unintended consequences. Let's examine four tips to consider when designing an incentive trust.

1. Focus on positive reinforcement

Avoid negative reinforcement, such as conditioning distributions on the avoidance of undesirable or self-destructive behavior, for example, gambling or drug use. This sort of "ruling from the grave" is likely to be counterproductive. Not only can it lead to resentment on the part of your heirs, but it may backfire by encouraging them to conceal their conduct and avoid seeking help.

Trusts that emphasize positive behaviors, such as going to college or securing gainful employment, can be more effective. Plus, accentuating the positive tends to discourage negative behavior; it's difficult for a substance abuser to stay in school or hold down a job.

2. Be flexible

Leading a worthy life means different things to different people. Rather than dictating specific behaviors, it's better to establish the trust with enough flexibility to allow your loved ones to shape their own lives.

For example, some people attempt to encourage gainful employment by tying trust distributions to an heir's earnings. But this can punish equally responsible heirs who wish to be stay-at-home parents or whose chosen careers require them to start with a low-paying, entry-level job or unpaid internship. A well-designed incentive trust should accommodate nonfinancial measures of success.

As you think about the incentives you wish to provide, avoid the temptation to "buy" desired behavior. Suppose, for example, that your trust provides generous distributions to a daughter who cares for her children full time. But what if she really wants to work outside the home? If the "stay-at-home bonus" is too large, she may feel she has little choice. A better approach is to reward your heirs for a variety of positive options and allow them to choose their own paths.

3. Consider a principle trust

Drafting an incentive trust can be a challenge. Rewarding positive behavior requires a complex set of rules that condition trust distributions on certain achievements or milestones, such as gainful employment, earning a college degree or reaching a certain level of earnings. But it's nearly impossible to anticipate every contingency.

> *Leading a worthy life means different things to different people.*

What if your heir becomes disabled and can't work or chooses to be a stay-at-home parent? What if your heir takes a low-paying job with a charity or not-for-profit organization? What if your heir foregoes college to pursue a worthy vocation, such as construction or auto repair? On the flip side, what if your heir becomes a "professional student," using the trust funds to pursue one impractical college degree after another?

One way to avoid unintended consequences is to establish a principle trust. Rather than imposing a complex, rigid set of rules for distributing trust funds, a principle trust guides the trustee's decisions by setting forth the principles and values you hope to encourage and providing the trustee with discretion to evaluate each heir on a case-by-case basis. Bear in mind that for this strategy to work, the trustee must be someone you trust to carry out your wishes.

4. Provide a safety net

An incentive trust need not be an all-or-nothing proposition. To keep your heirs off the street, offer sufficient funds to provide for their basic needs and base additional distributions on the behaviors you wish to encourage.

A balanced approach

According to Warren Buffett, the ideal inheritance is "enough money so that they feel they could do anything, but not so much that they could do nothing." A carefully designed incentive trust can help you achieve this goal. Talk to your estate planning advisor for more details. ∎

Estate planning and asset protection planning go hand in hand

As a business owner, your company is likely your most valuable asset. And you know that you must account for it in your estate plan to help ensure that it remains a valuable asset for your heirs. Thus, a key goal should be to insulate your company and other assets from the claims of creditors and lawsuits.

When you create an asset protection plan proactively, you add a layer of protection before any claims or lawsuits arise. This can deter creditors and possibly thwart the seizure of assets.

Ownership structure matters

Depending on the structure of your business, you may have adequate protection from creditors, minimal protection or none at all. Thus, you might consider changing the ownership structure to create a corporate shield. Here are the three primary forms of ownership:

C corporation. Generally, a C corporation provides limited liability exposure to the personal assets of its principals. There's no personal liability for corporate debts, contract breaches or personal injuries to

third parties caused by the corporation or its employees. So, a creditor can't seize your personal assets if the corporation can't pay its bills. This is a distinct advantage over traditional partnerships.

But be aware of an exception for certain personal services. For example, a physician might be held personally liable for damages incurred while performing services on behalf of a medical practice. In other situations, personal liability may be attached if the corporation has no significant assets and doesn't really act as a separate entity.

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S corporation. With an S corporation, income and losses are passed through to shareholders on a personal level, thereby avoiding "double taxation" faced by C corporations. Like a C corporation, however, shareholders benefit from some corporate liability protection, albeit with additional limits as to the number and type of shareholders, allocation of profits and losses among shareholders, and the type of stock that may be issued to investors. For many business owners, an S corporation is the preferred choice.

Limited liability company (LLC). An LLC operates much like an S corporation without some of the extra formalities. Significantly, LLC principals are afforded the same liability protection as those in a C corporation, along with the favorable "pass-through" tax benefits available to an S corporation.

Note that filing requirements and creditor protections for LLCs may vary from state to state. Nevertheless, state laws generally protect personal assets of LLC owners from claims based on LLC activities.

Build asset barriers

Most asset protection strategies for businesses involve putting up walls between a company and its assets. One way to do this is to divide the business into separate entities.

For example, you may want to form separate entities to conduct any business activities that are riskier than others. Doing so allows you to limit the liability risk associated with them. Provided the entities are structured and operated properly, you can prevent creditors from going after assets owned by other entities within the group, even if they have common ownership.

Another way to protect valuable business assets is to sell them to another entity created by the company's owners and then lease them back. If done right, these assets no longer belong to your company, so they're beyond the reach of the company's creditors.

Talk to the professionals

Owning a business is a big responsibility, and you want your children to benefit from your hard work after you're gone. Thus, it's important to implement business asset protection strategies. Because these strategies can be complex, talk to your business, estate planning and legal advisors to determine your best course of action. ▮

ESTATE PLANNING RED FLAG

You haven't planned for the death of beneficiaries

When planning for the disposition of your estate, it's critical to understand what happens if a child or other beneficiary predeceases you. There's no one right way to deal with this contingency, but to avoid unintended results your estate plan should spell out, with precise language, how your estate should be divided among loved ones.

If you use incorrect or vague language, you could unintentionally disinherit family members. For example, two common distribution methods are per capita, which means "by the head," and per stirpes, which means "by the branch." Let's suppose that Zeke has three children — Abe, Betty and Carl — and that Abe has three children and Betty and Carl each have one child. If Zeke leaves his assets to his children per capita, then they will be divided equally among them. If Abe predeceases Zeke, then his assets will be divided equally between Betty and Carl, effectively disinheriting Abe's three children. Had Zeke left his assets to his children per stirpes, then Abe's children would have split his one-third share.

Another distribution method is by representation, under which all members of the same class or generation are treated equally. This method works similarly to per stirpes unless more than one child predeceases you.

Going back to the previous example, suppose that both Abe and Betty predecease Zeke. If his assets are distributed by representation, then Carl would receive one-third, while Abe and Betty's children would split the remaining assets four ways. Under the per stirpes method, Carl would receive one-third, Betty's child would receive one-third and Abe's children would split the remaining third three ways.

If the language in your estate plan is vague, or you fail to specify a distribution method, state law may designate a method by default.

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Inflation's Upside, at least in Estate Planning

The IRS feels your pain when it comes to inflation and has substantially increased exemptions for gift giving for 2023. But it's critical to start planning now because some of those exemptions are scheduled to drop substantially for 2026.

While inflation hurts day-to-day, it can actually be helpful for certain estate planning issues courtesy of the IRS—at least, for a year or two.

In 2023, IRS-set exemptions for the estate, gift, and generation skipping transfer taxes (GST, for short) have increased—a lot by traditional standards. The annual individual gift exemption, for example, is up 6.25 percent, to $17,000 from $16,000. And the GST exemption has jumped by just over 7 percent, to $12.92 million from $12.06 million.

Both exemptions are record-high increases, and they might open a window of significant opportunity.

That's good news, of course, and, of course, it won't last forever. But by working with us now, you'll have plenty of time to make the most of these increased exemptions. (The bad news, just so you know, is that the window closes in 2026, when the estate, gift, and GST exemptions will be reduced to $5 million, as adjusted for inflation.)

Your estate plan is unique and tailored to you. But here are some things to keep in mind.

Annual Gifts: These are relatively straightforward. Individuals can gift up to the designated amount each year tax free without reducing any of their lifetime gift and estate tax exemptions. The challenge is how much to use and who should you benefit. There are many options available to you, which range from outright gifts to irrevocable trusts. Currently, up to $175,000 can be gifted tax-free to a spouse who is not a US citizen.

GST (Generation Skipping Transfer): This can be trickier because there are a number of options, each with its own advantages and disadvantages. The pros and cons depend on your specific assets, goals, and, yes, uncertainties that are yet to be resolved. We're here to help you recognize and account for such uncertainties.

Comment: Even if you've already maxed out your estate, gift, and GST exemptions, the new exemption limits offer opportunities to benefit your family and friends.

Here are some of the issues we can review together.

Heirs: Even though you know that you want your children to receive your assets, outright gifts may not be the complete answer. Depending on their personalities, goals, and career plans, for example, perhaps it might make sense to place some boundaries around your gifts. Could they spend too much too fast? If they're married, could the gifted assets be subject to division in the unlikely event of divorce? Could your grandchildren be left out? One answer to potential problems is a trust. But which type?

Trusts: There are many kinds to consider, and they must be carefully navigated. For example, at what age, if any, will a child have complete control over gifted assets and/or begin to act as sole trustee of their own trust? (Not as unlikely these days as you might think.) Depending on your resources, access to funds will become important.

The IRS: While the IRS is, for right now, your friend in our discussion when it comes to inflation, poorly established trusts can backfire. The rules regarding the taxation of trusts are complex and require discussion as to the goals you seek to achieve. Fortunately, one size does not fit all. Together we can consider the possibilities that suit your objectives and explore the implications.

Naturally, that's not all there is to think about. Set up a call or a meeting with us to think through your tax-planning needs, whatever they may be. We think you'll find that two heads really are better than one.