Tax-Efficient Funding of Long-Term Care Insurance
By Gary Case

Thanks to the Pension Protection Act passed by Congress, beginning in 2010 certain annuity payments may be used to fund premiums on long-term care insurance policies without incurring federal income tax. Additionally, premium payments for long-term care insurance may also be tax deductible to the purchaser. The key to taking advantage of this tax-reducing opportunity is the willingness of the insurance company that issues the annuity to; 1) make payments directly to the long-term care policy, and 2) report zero income from annuity payments. There are several companies willing to do so. The Pension Protection Act language permitting this technique refers to the tax-free exchange of assets between annuities and certain insurance policies (IRS Section 1035 for those of you who wish to research this further—look closely at partial exchanges).

If you already own an annuity, you might be able to use that money to fund policy premiums. You could also convert a low-yielding money market fund or certificate of deposit into an immediate annuity, which can be structured to pay a series of level or increasing payments over your lifetime (or even over joint lifetimes, if desired). A caveat that should be considered if a level payment option is selected, long-term care premiums can increase which would require you to fund the increase in premium from another source.

Readers who listen to Dave Ramsey know that he recommends (requires?) long-term care insurance as an integral component to financial security for families (not just elderly family members). Nest eggs can be depleted with amazing rapidity in the event of a spouse/parent requiring long-term care, either at home or in a facility. I have previously stated in this column that most of us who reach age 65 will need help at some point. A 2007 AARP study on long-term care trends states the two thirds of those over age 65 will require long-term care.

Another benefit to purchasing a long-term care policy is related to what happens when a person applies for Medicaid. Medicaid is welfare and is only available to the impoverished. Without getting into too much detail, Medicaid recipients must essentially spend their money first to provide for their care prior to applying. However, because Idaho participates in a Medicaid "Partnership" program, money paid towards long-term care from a Partnership qualified long-term care insurance policy can offset, on a dollar-for-dollar basis, assets that would otherwise have to be spent prior to applying for Medicaid. For example, if a total of $300,000 were paid out of a qualified policy for long-term care, $300,000 in other assets would be protected (not counted as having to be spent) when applying for Medicaid.

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