The new wealth transfer

Allison Anne Hoyt, JD, CLU®
Technical Director, Advanced Consulting Group

Today, it is estimated that individuals reaching age 65 will have a 52% chance of needing long-term care at some point in their life.[1] At the same time, due to the dramatic increase in the federal estate tax exemption, less than 1% of the population can expect a federal estate tax at their death.[2]

For the overwhelming majority of Americans, wealth transfer needs to focus on planning for the costs of long-term care - not on estate taxes. The new wealth transfer should include some form of long-term care insurance coverage.

However, many of our mass affluent clients with a household net worth between $100,000 - $5,000,000 have put their life insurance policies in irrevocable trusts (e.g., irrevocable life insurance trusts or ILITs) for the purpose of avoiding the estate tax. Due to changes in the law several of these clients may no longer face exposure to the estate tax. Getting rid of their ILITs, however, is not advisable – ILIT planning should not be "unwound" for several reasons including the multiple benefits of having an ILIT and the fact that no one knows where the estate tax exemption will be in the year of their death. Instead, these trusts should be kept and can be repurposed to protect against the costs of long-term care. The ILIT then becomes a multi-faceted wealth transfer vehicle for our mass affluent clients who will now have greater flexibility in how to most appropriately address their wealth transfer and long-term care needs. This is how optimal wealth transfer for these clients can likely be achieved.

For our high net worth clients who have ILITs and still face certain exposure to the estate tax, adding a long-term care component to these trusts can further enhance their wealth transfer plans and even reduce the ultimate amount of estate taxes payable by their estates!

These recommendations for our mass affluent and high net worth clients are explored more fully, below.

Average Cost of Care Columbus, OH[3]				
	Annual 2022	5 years	**Annual 2042[4]**	**5 years**
Private Room Nursing Home	$101,000 / year	$505,000	**$202,000**	**$1,010,000**
Assisted Living Facility	$63,000 / year	$315,000	**$111,000**	**$555,000**
Home Health Aid	$52,000 / year	$260,000	**$93,000**	**$465,000**

THE BENEFITS OF HAVING LTC COVERAGE

This table lists the average cost of care of various long-term care services in Columbus, Ohio (2022). A private room at a nursing home is the most expensive option with an average cost of $101,000 per year. Whereas, the average cost of a year in an assisted living facility is $61,000 and having a home health aid for a year, on average, will cost about $52,000 (assuming a 40 hour work week). This table also shows the cumulative cost of those services after only 5 years. What will the costs of these services be in 10, 20 or 30 years when our clients are likely to need them? If we were encouraging our clients to insure for an estate tax liability of these amounts, why would we not also encourage our clients to insure for a long-term care liability of similar amounts?

The costs of long-term care have become the new estate tax for our mass affluent clients - meaning that although their estates will not likely be diminished by a 40% estate tax on amounts over an exemption, their estates will likely be reduced by similar amounts paid to the various providers of long-term care services. Not insuring for long-term care is another threat against these households' estate plans and jeopardizes their ability to leave a legacy. Further, mass affluent households may not have the cash flow or liquidity to pay out of pocket for these long-term care services and may be forced to sell assets at disadvantageous times (i.e., fire sale).

For high net worth households, those who still face exposure to an estate tax under current law, the costs of long-term care are another eroder of wealth, however insuring against this potential event and using the strategy outlined below can actually be an additional estate tax mitigation strategy for them.

If either our mass affluent or high net worth clients have or will have ILITs, adding long-term care insurance coverage to the policies within the ILITs should be explored.

THE BENEFITS OF HAVING AN IRREVOCABLE TRUST (E.G., ILIT)

Irrevocable trusts can provide much more than estate tax liquidity. Any assets transferred to an irrevocable trust are generally protected from the grantor (and beneficiaries') creditors. In addition, those assets will avoid probate at the grantor's death which will be a private transfer of wealth (vs. a will, which is a public document).

The ILIT can be named as the owner or beneficiary of any number of assets. If assets remain in trust after the grantor's death, the irrevocable trust can provide further creditor protection and possibly professional money management for trust beneficiaries.

The worst that can happen by keeping an ILIT is that the grantor has given his/her loved ones a larger inheritance. Whereas, the worst that can happen by terminating an ILIT is that the estate tax laws change, and the grantor ends up facing an estate tax at death, forcing a fire sale of assets and diminishing the grantor's legacy.

ADDING LTC COVERAGE TO AN IRREVOCABLE TRUST (E.G., ILIT)

The first step in adding LTC coverage to an ILIT is for the trustee to determine what kind of long-term care coverage is most appropriate. The two most fitting options for long-term care coverage that complement an estate plan are either a life insurance policy with long-term care rider or a linked-benefit (i.e., hybrid) long-term care policy. A standalone long-term care policy is not ideal for a variety of reasons, namely its "use it or lose it" nature and almost all standalone policies are reimbursement contracts (vs. indemnity).

If a life insurance policy with long-term care rider is selected, the trustee may be able to have the rider added to a pre-existing policy inside the ILIT. A few carriers do allow the long-term care rider to be added post-issue. The insured will have to be insurable for long-term care at the time the rider is issued. If a rider cannot be added post-issue or if a different type of life insurance policy is more appropriate, the trustee can complete a tax free 1035 exchange for a new life insurance policy with long-term care rider. Note that the insured will have to be insurable for both life insurance and long-term care insurance in this instance.

Alternatively, the trustee may determine that a linked-benefit long-term care policy is more desirable. These types of policies typically offer greater long-term care benefits than a life insurance policy with long-term care rider. The trustee could 1035 exchange the pre-existing life insurance policy for a linked-benefit long-term care policy. The insured will need to be insurable for both life insurance and long-term care in order to complete the 1035 exchange.

For our high net worth clients just setting up an ILIT, either of these products may be purchased by the trustee, ab initio; or it may make sense to purchase an additional product in a pre-existing ILIT that is dedicated for future long-term care expenses.

In either case, for optimal estate planning to be achieved, the trustee will want to select a product that pays long-term care benefits on an indemnity basis (vs. a reimbursement basis). Indemnity benefits offer the trustee the most flexibility and administrative ease and provide the greatest potential financial benefit.

If the insured ends up having a long-term care event, there are several ways the trustee can ultimately use the long-term care benefits. See below for a few such examples. Ultimately, the net result is that more of the insured's estate will be preserved for the next generation and monies needed for a long-term care event can be readily available. If the insured ends up not having a long-term care event, the trustee will receive the full death benefit from the insurance carrier and manage the proceeds for the betterment of the trust beneficiaries.

REPURPOSING AN ILIT FOR LTC: SLAT OR BLAT PROVISIONS ARE KEY FOR MASS AFFLUENT CLIENTS

Mass affluent clients who already have ILITs, but are no longer exposed to the estate tax, should keep their trusts and the policies within them, but repurpose their ILITs for the costs of long-term care, as explained above.

Nationwide, like many other carriers, will pay LTC benefits to the policy owner. In the case of an ILIT, LTC benefits would be paid to the trustee. In a typical ILIT, the grantor (creator) of the trust is also the insured of the insurance policy; this person is neither trustee nor a trust beneficiary. Therefore the trustee cannot distribute LTC benefits to the insured experiencing a LTC event. However, if the trust was drafted with SLAT or BLAT provisions (spousal lifetime access trust or beneficiary lifetime access trust) the trustee may make distributions of LTC benefits to a trust beneficiary – typically the grantor's spouse or child.

To facilitate the payment of LTC benefits to a trust beneficiary, ideally the trust was drafted with a discretionary distribution standard (i.e., the trustee has discretion over how much and to whom to make trust distributions). Otherwise, the so-called ascertainable standard will likely not provide relief as the distribution is not necessarily for a trust beneficiary's health, education, maintenance, or support. An independent trustee is also ideal, one who is not related or subordinate to the grantor. If the grantor's spouse is a trustee and beneficiary, an additional trustee who is an independent trustee can be empowered to make discretionary distributions.

In many instances, if the grantor's spouse or child has fronted the monies needed for the grantor's long-term care expenses, the ILIT serves as a ready source of funds to indemnify that individual for their outlay.

If the trust does not have SLAT or BLAT provisions, there are a few options. Almost all trustees are empowered to make loans, so a loan of LTC benefits may be possible. Alternatively, the trust may be able to be reformed (i.e., changed) with or without a court process. Decanting the assets of the ILIT to a new ILIT with more desirable provisions may be a possibility, similarly a sale of the policy from the current ILIT to a new ILIT with more desirable provisions may also be explored.

ADDING LTC COVERAGE TO AN ILIT: ESTATE TAX MITIGATION FOR OUR HIGH NET WORTH CLIENTS

Repurposing an ILIT for long-term care makes a ton of sense for our mass affluent families who otherwise could see their estates significantly diminished by the costs of long-term care. Adding LTC coverage to an ILIT makes even more "dollars and cents" for our high net worth clients who are exposed to the federal estate tax. Although this group may scoff at the notion of purchasing insurance for a long-term care event, their ears should perk up when they learn more about the potential costs of long-term care services and that doing so can be an effective estate tax mitigation strategy.

If the grantor experiences a long-term care event, again there are several ways that the LTC benefits payable to the ILIT can facilitate both the payment of long-term care expenses as well as estate tax mitigation for the grantor. For example, if SLAT or BLAT provisions are present, the trustee may distribute the LTC benefits from the trust to the grantor's child who then may loan those benefits to the grantor. The loan would be a debt against the grantor's estate and decrease the value of his/her taxable estate and thus the amount of estate tax ultimately assessed against it. The key to using a loan strategy for estate tax mitigation is the accrued and capitalized interest on the loan; this capitalized loan interest represents pure estate tax savings! The greater the LTC benefits paid, the longer the grantor lives, the greater the accrued and capitalized interest, and the greater the estate tax savings.

THE PROCESS OF TAKING THE COLLATERALIZED LOAN

With regards to the terms of the loan, it must be an arms-length, fully collateralized transaction that is secured by property pledged by the grantor. Specifically, the loan must be legitimate, with collateral pledged, interest charged, and an agreement to fully pay back the debt.

Collateral can be anything with a fair market value that covers the debt: a house, artwork, coin collections, etc. The interest rate charged should be reasonable but at least equal to the interest charged on policy loans from the insurance policy. The loan interest can be accrued and capitalize regularly.[5]

CONCLUSION

The new wealth transfer should include protection against the potential future costs of long-term care, which, regardless of your level of wealth, can be significant.

For the mass affluent who already have ILITs that are no longer suited to their original purpose, they can still play an important role in an estate plan if they are repurposed to provide funding for potential long-term care costs. Moreover, if transfer tax laws change in the future to again expose such grantors to an estate tax liability, they and their heirs will sure be glad that they did not get rid of their ILITs or the insurance policies within them! Instead, the grantor will be in a position of strength as both life insurance and long-term care coverage in an irrevocable trust offers the most flexibility to determine the most appropriate use of the insurance policy within the ILIT.

For the high net worth with more certain exposure to the estate tax, adding long-term care coverage to their irrevocable trusts can be an additional estate tax mitigation strategy which keeps more wealth within their family and less wealth from going to the I.R.S. Regarding the details of how to add LTC coverage to an ILIT, there are, as previously discussed, legitimate alternatives with the appropriate choice depending upon the facts and circumstances of the case and the interests of the parties involved.

This material is not a recommendation to buy or sell a financial product or to adopt an investment strategy. Investors should discuss their specific situation with their financial professional.

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[1] "70%" - It's Baaack! Kind of..." Bill Comfort - CSA, CLTC, LTCCP, Published on December 13, 2020. In addition, when it comes to the risk of needing care, according to Health View Services, an average healthy 65-year-old *married couple* has a 75% chance that one partner will require LTC. Think Advisor: **"**What Are the Odds Your Client Will Need Long-Term Care?" by Michael S. Fisher, June 22, 2021.

[2] According to a 2015 study; with passage of 2017's Tax Cuts and Jobs Act, the amount of people exempted from the federal estate tax should be even higher. Joint Committee on Taxation, "History, Present Law, and Analysis of the Federal Wealth Transfer Tax System," 9 July 2018, https://www.jct.gov/publications.html?func=startdown&id=4744.

[3] Nationwide, Compare Long-Term Care Costs from State to State map, https://nationwidefinancialltcmap.hvsfinancial.com, accessed June 29, 2022.

[4] The inflation rates assumed are based on publicly available cost of care surveys from 2016 to 2018. The actual future costs of care will be different from the historical cost of care.

[5] Note that any outstanding accrued interest (i.e., not capitalized) that is repaid after the grantor's death would be taxable as income to the trust.