Long-Term Care Investment and Tax Impact Study

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LONG-TERM CARE TAX AND INVESTMENT IMPACT STUDY

Abstract

In planning for retirement, people too often dismiss the need for long-term care (LTC), often feeling its costs are not worth insuring now. Yet attorneys, certified public accountants, investment advisors, and insurance agents—all of whom act as fiduciaries and put their clients' needs first—should stress the importance of planning for LTC with their clients. The likelihood of a person needing LTC, especially as the average lifespan increases, cannot be ignored. The Long-Term Care Investment and Tax Impact Study is an unbiased tool to help fiduciaries educate clients about the effect LTC can have on their income tax and investments. The study examines the tax impact on a middle-income couple's retirement lifestyle over five years, using standard and medical deductions, creating a tax positive approach to taxation during this time. Although the investment portfolio earns interest, the study demonstrates how the cost of care affects the portfolio's growth. The study addresses and compares the effects of three scenarios: (1) having no insurance, (2) the use of long-term care insurance, and (3) using government programs and presenting planning techniques for clients that don't qualify for long-term care insurance.

The Study

The study analyzes the investment and tax impact of long-term care planning. The examples are hypothetical and focused on federal income tax calculations based on the information, tax tables, and regulations at this time.[1] The study examines and compares three scenarios, one with no planning and two with different types of planning.

Facts

Seven out of ten people over age 65 will need long-term care.[2] The National Association of Insurance Commissioners, the oldest association of state and government officials, describes long-term care as "different from medical care, because it generally helps you to live as you live now instead of improving or correcting medical problems."[3]

Rough statistics show that 30% of caregivers die before those they are caring for. some studies show deaths higher. Illness that doesn't lead to death is rampant, as well—depression and auto-immune diseases are high on the list.[4]

Plan Options

Prior to retirement, John and Mary met with their team of professionals (estate planning attorney, CPA, investment professional, and insurance professional) to update their plans. The outcome of these meetings was the basic estate planning document, a real estate trust for their residence, and an LLC for their rental property.

The following three scenarios reflect other, differing decisions they may make and the ramifications and consequences of those choices. Scenarios 1 and 2 present opposite ends of the spectrum—no planning for long-term care versus planning, respectively—and the tax consequences of each. Scenario 3 presents options that can be used in connection with scenario 2 and for those who cannot qualify for long-term care insurance.

Expenses, Income, and Assets Snapshot

Prior to John needing care, the couple's lifestyle was centered around the following financials:

Expenses	$130,000 annually
Income	$140,000 annually
Real Estate Assets	$2,000,000 (primary residence and summer cottage)
Liquid Assets	$2,080,000
Life Insurance	$520,000

Background for Scenarios 1, 2, and 3

Scenario 1
This scenario presents the tax baseline John and Mary will experience if long-term care planning is not done but is needed.

When John and Mary met with their team of professionals, long-term care insurance was brought up, but John and Mary brushed it off as too expensive and likely would never be needed. Alternative LTC planning, excluding insurance, was never discussed. As far as John and Mary were concerned, they had no reason to consider LTC planning. No further education or analysis to address their concerns was presented. Tax implications and LTC risk exposure were never explored. Overall, John's and Mary's initial thoughts were never disputed, and options to pay for LTC were never examined. Their fiduciaries failed to do their due diligence and their duty.

Scenario 2
This scenario presents the tax issues when long-term care planning is done and care is needed.

When John and Mary were 50 years old, they met with their team of professionals, and long-term care insurance was discussed. Initially, John and Mary brushed it off as too expensive and likely would never be needed. However, after their team discussed and educated John and Mary on the statistics of needing care, the options and benefits that can be provided, the impact on their retirement portfolio, and the tax consequences, John and Mary decided their team of professionals should perform their due diligence and present a financially efficient plan conducive to their needs.

With the knowledge and persistence of their fiduciaries, John and Mary now understand that a long-term care plan that includes life and long-term care insurances will help protect their assets from spend-down and unnecessary taxation. This will also help avoid paying entirely for long-term care, if needed, while allowing one or both John and Mary to use legal documents (trusts) and government-funded programs.

Understanding they may never need the use of their non-qualified funds, John and Mary, along with the help of their team of professionals (attorney, CPA, investment advisor, and insurance agent), established a plan to eventually (potentially when they are in their 70s) use an irrevocable Medicaid trust and an irrevocable life insurance trust (ILIT).

In doing this, John and Mary understand there will be separate tax structures, one for their personal income taxes and a separate one for each trust to manage any tax consequences. A trust is a separate entity and has its own tax identification number (TIN), similar to a Social Security number.

After comparing standalone LTC insurance policies to life insurance policies with a linked long-term care rider, both John and Mary chose to have standalone long-term care policies. Their individual monthly benefits at age 80 are $19,419 with an overall benefit pool of $699,052, of which a portion can be used as cash such as an indemnity policy. Their policies waive the premium upon claim. John's policy cost him $3,755 a year, and he paid the premium for 30 years until going into claim when he had his stroke and needed care. Total cost of John's policy is $112,650. John and Mary also have a shared policy, meaning Mary can share a portion of her policy with John if needed. If John predeceases Mary, the remainder of his policy benefit will transfer to Mary. For the sake of this study, the premium never increased. The couple also have a permanent life insurance policy that will recover the cost of their long-term care insurance policy when they die.

Scenario 3

This scenario presents a planned and well-managed option that can be used in connection with Scenario 2 above and for those who cannot qualify for long-term care insurance.

John and Mary followed their fiduciaries' direction as discussed in Scenario 2. Due to family history/medical issues, John did not qualify for long-term care insurance while Mary did. Because John was unable to obtain LTC coverage and Mary was, Mary's benefits need to be greater since her plan is an individual program with no opportunity to receive shared benefits.

Knowing that Mary has long-term care insurance benefits and John is uninsurable is valuable. The team (estate planning attorney, CPA, and financial professionals) can now create legal, tax, and investment plans, shifting the financial holdings to Mary, protecting assets from John if he needs long-term care, while protecting Mary's assets upon her demise. The estate planning attorney can create and fund a Medicaid trust (funded during Mary's lifetime) and a qualified retirement trust (funded after her death), which holds the assets outside the Medicaid recovery system.

The objective, if John needs long-term care, is to provide the necessary tools and services for in-home care. Assisted living communities would be the next step, and skilled nursing facilities (nursing homes) would be the final step if unavoidable.

Everyone benefitted by learning when John was 50 that he would not qualify for LTC insurance. The team could plan appropriately. Assets were shifted over to Mary, having the potential to stretch tax consequences over 20 to 30 years, and legal documents were put in place to house assets, creating controlled tax exposure, an advantage to John and Mary.

Changing the way John and Mary will save moving forward is also a valuable maneuver. Creating a larger pool of protected non-qualified funds in trusts and liquid Roth assets is key to their ability to protect their portfolios and minimize their income tax. One portfolio is protected in a separate entity or entities, and another is available for their use. Although Roth accounts are qualified assets and follow the rules of qualified money, they have already had income tax consequences and could easily be converted into non-qualified tax status and then protected in trusts if needed. Considering the lookback period, currently 5 years is essential in this scenario.

Although John's employer is contributing to his 401(k), John's contributions should not be above what his employer is matching. Collecting more qualified assets can be detrimental, moving forward. Paying income tax on earnings now will provide greater opportunity to pay less income tax during retirement and allow him to protect assets sooner.

At age 50, Mary and John have time to strategically organize and implement a tax plan and thus to distribute larger amounts of qualified assets beginning at age 59½ to cover income taxes and to create the funds to become Roth and readily protectable non-qualified funds.

By implementing investment strategies and government-supported programs, a long-term care plan structured with a tax plan is assembled for John without long-term care insurance, in coordination with Mary having LTCI. Furthermore, Mary's individual documents protect the assets in the event she exhausts her LTC benefits or predeceases John.

To understand the financial impact long-term care has on an investment portfolio and the tax details of each scenario leading to the comparison scenarios below:

Click **appendix A** to examine Scenario 1
Click **appendix B** to examine Scenario 2
Click **appendix C** to examine Scenario 3

Comparing Scenarios: Investment Portfolio Impact

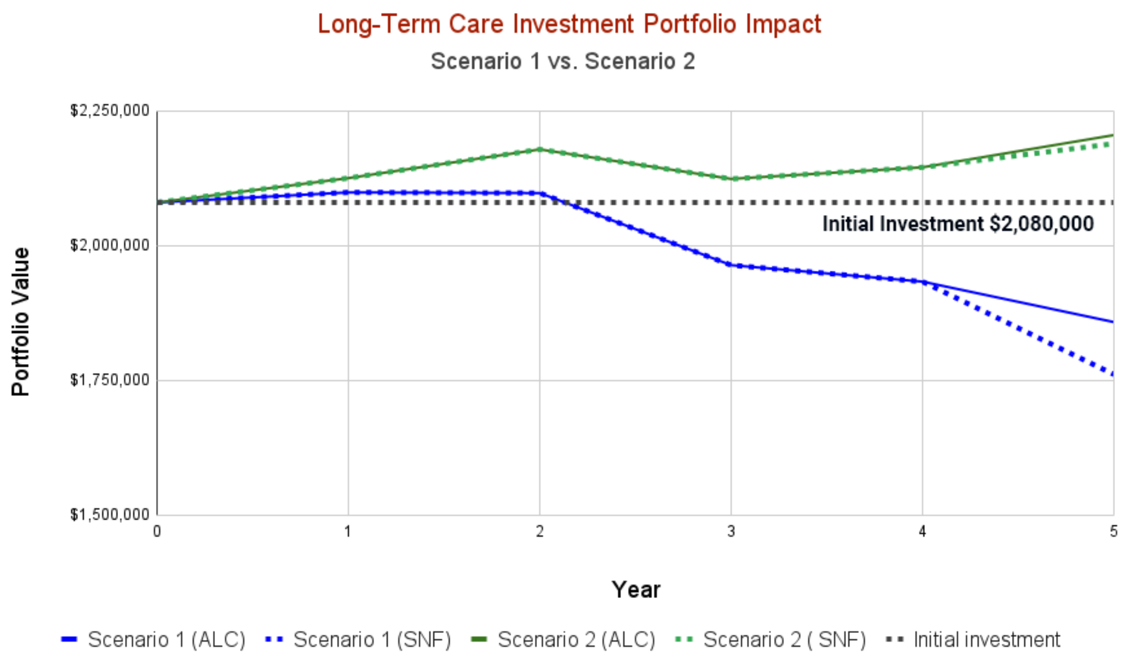
The graphs in the following discussions offer visual perspectives of the investment and tax impact for each scenario and compares the scenarios for an overall understanding of the impact long-term care can have on a portfolio and the role income tax plays.

Scenario 1 vs. Scenario 2
Scenario 1 experienced minimal planning. The investment portfolio recognized a loss of $222,014 for an assisted living community (ALC) and $319,233 for a skilled nursing facility (SNF) due to long-term care expenses, not including household use, as presented in figure 1, below.

Scenario 2 experienced planning to include long-term care insurance at a cost of $112,650. The portfolio recognized a gain of $125,079 for ALC and $109,179 for SNF (skilled nursing facility) over the 5-year period. The gain is after the cost of maintaining distributions for household use.

In total over the 5 years, Scenario 2 did better than Scenario 1 by $347,093 for ALC and $428,412 for SNF.

Figure 1



End of Year	**Scenario 1** Portfolio Value	**Scenario 2** Portfolio Value
1	$2,098,800	$2,125,300
2	$2,097,528	$2,178,618
3	$1,963,680	$2,123,834
4	$1,933,101	$2,145,359
5A (ALC)	$1,857,986	$2,205,079
5B (SNF)	$1,760,767	$2,189,179

CONCLUSION: If insurability is certain, Scenario 2 is less costly. If one is accepted into an assisted living community, the lifestyle and impact on the portfolio are favorable in both scenarios.

Scenario 1 vs. Scenario 3

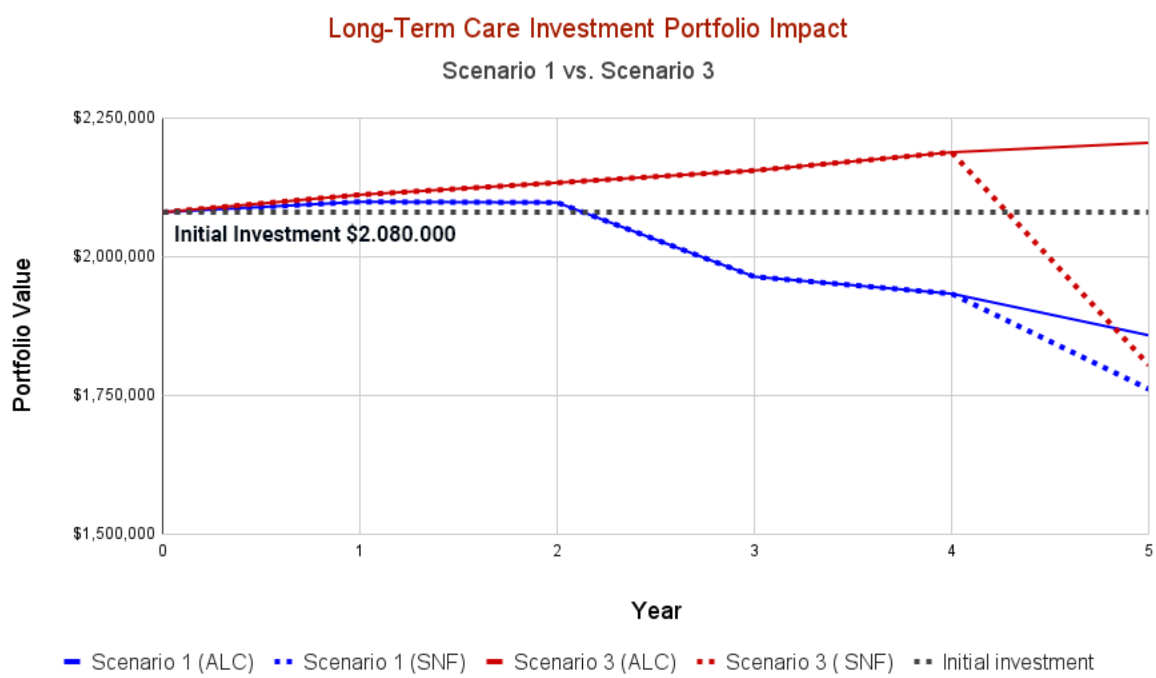
Scenario 1 experienced minimal planning, and Scenario 3 experienced planning outside the use of long-term care insurance. Figure 2 below demonstrates the impact planning offers.

Scenario 1 experienced a loss of $222,014 for ALC and $319,233 for SNF.

Because of the planning used in Scenario 3, the portfolio gained $125,569 for ALC and lost $27,707 for SNF after normal (household) distributions.

In total over the 5 years, Scenario 3 did better than Scenario 1 by $347,583 ($222,014 + $125,569) for ALC and $291,526 ($319,233 − $27,707) for SNF.

Figure 2



End of Year	**Scenario 1** Portfolio Value	**Scenario 3** Portfolio Value
1	$2,098,800	$2,111,520
2	$2,097,528	$2,133,272
3	$1,963,680	$2,155,269
4	$1,933,101	$2,188,126
5A (ALC)	$1,857,986	$2,205,569
5B (SNF)	$1,760,767	$1,804,306

CONCLUSION: Planning is a major contributor in Scenario 3's favorable impact to the portfolio in comparison to Scenario 1. In both scenarios, assisted living communities were less costly to the portfolio and considered a more desirable lifestyle.

Scenario 2 vs. Scenario 3
Both scenarios have planning involved, one with long-term care insurance (Scenario 2) and the other without (Scenario 3), as demonstrated in figure 3, below.

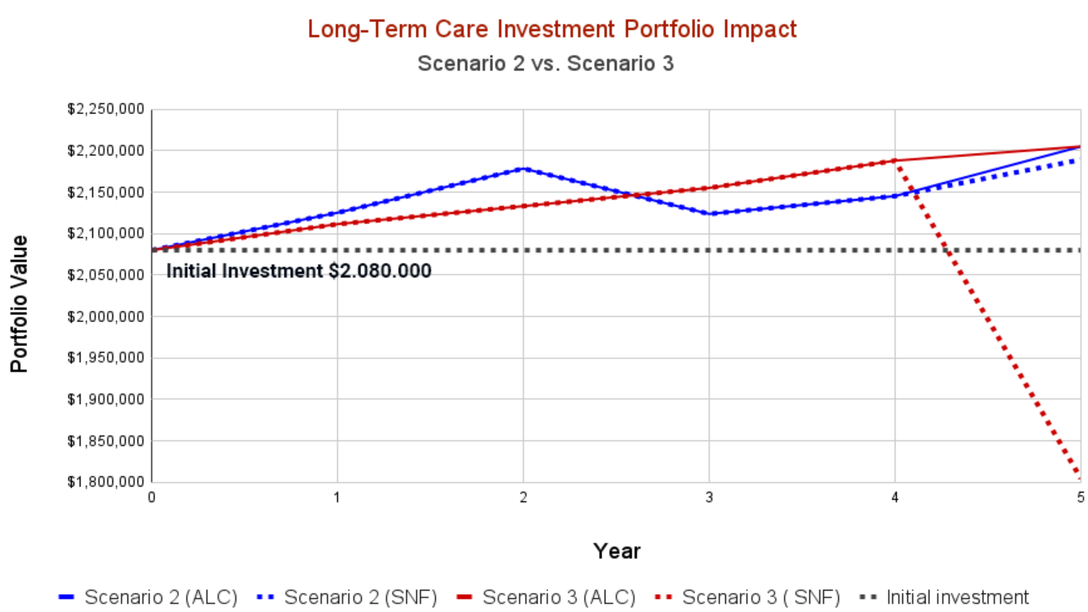
Scenario 2 recognized a gain of $125,079 for ALC and $109,179 for SNF over the 5-year period.

Scenario 3 gained $125,569 for ALC and lost $27,707 for SNF.

ALC for Scenarios 2 and 3 resulted in positive impacts to the portfolio of $125,079 and $125,569, respectively, with Scenario 3 doing better by $490.

Comparing SNF for the two scenarios, Scenarios 2 saw a positive impact to the portfolio of $109,179, while Scenario 3 resulted in a negative impact of $27,730. This was a total difference of $136,909 in Scenario 2's favor.

Figure 3



End of Year	**Scenario 2** Portfolio Value	**Scenario 3** Portfolio Value
1	$2,125,300	$2,111,520
2	$2,178,618	$2,133,272
3	$2,123,834	$2,155,269
4	$2,145,359	$2,188,126
5A (ALC)	$2,205,079	$2,205,569
5B (SNF)	$2,189,179	$1,804,306

CONCLUSION: Planning is a major participant in both scenarios. Scenario 2 leveraged the individual's health by using long-term care insurance, while Scenario 3 recognized the inability to qualify for long-term care insurance and rearranged the investment and legal portfolio to work with government programs to minimize the financial burden. With the exception of year 5B (SNF) for Scenario 3, the portfolio growth continues well above the initial investment level.

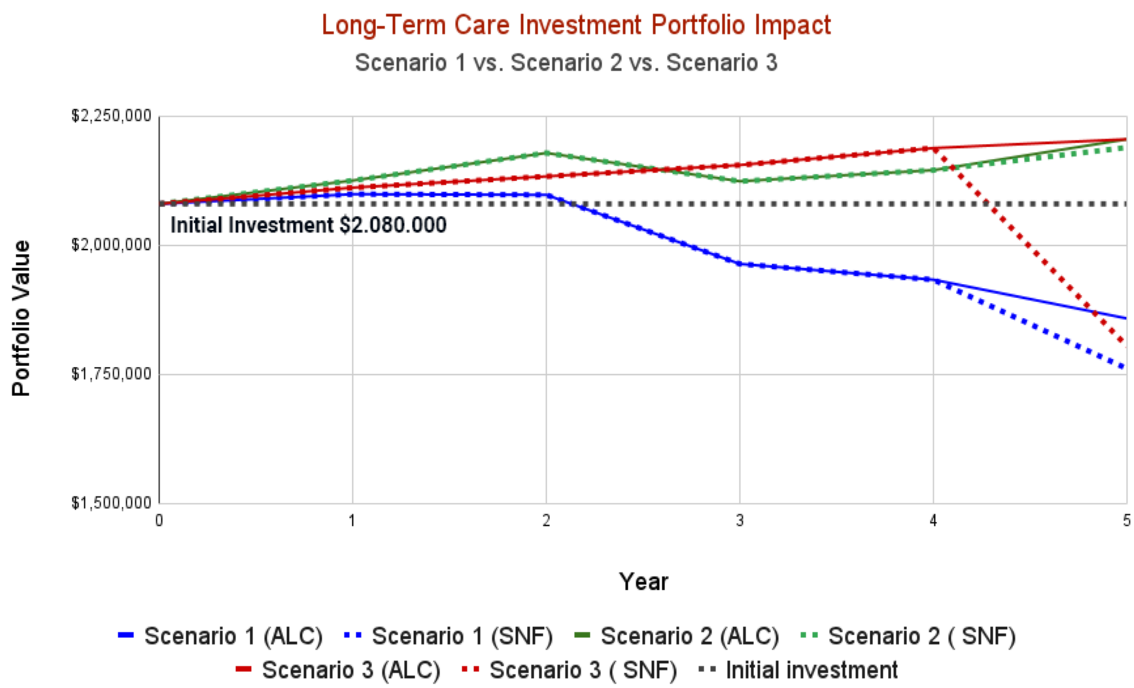
The comparison between these scenarios is circumstantial based on health. Assisted living communities are considered a preferred way of living if in-home care is not or no longer available. Scenario 2 is considered a better solution to the problem.

Scenarios at a Glance Comparison

As presented in figure 4, on next page:

- Scenario 1 has the worst investment impact, while Scenarios 2 and 3 are competitive.
- Scenario 3 requires a vast amount of sophisticated planning, including substantial changes to the investing style and habits.
- Scenario 2 provides support and protection against the detrimental concerns long-term care presents while maintaining a less invasive legal and investment approach than Scenario 3.
- Overall, Scenario 2, is the most effective approach to satisfying long-term care needs while preserving the integrity of the investment portfolio and its growth.

Figure 4



Comparing Scenarios: Income and Tax Impact

Scenario 1 demonstrates how medical deductions affect ordinary income. Figures 5 and 6, below, compare taxable income without long-term care to taxable income with long-term care. As income increases due to distributions caused by long-term care expenses, the medical deduction offsets some of the income tax impact.

The increased income and taxes in year 3 reflect home renovations to accommodate long-term care needs, while the return of the reimbursement cycle asset added to income, reducing the qualified distribution in year 5. Otherwise, years 3 and 5 would follow the normal path.

Figure 5

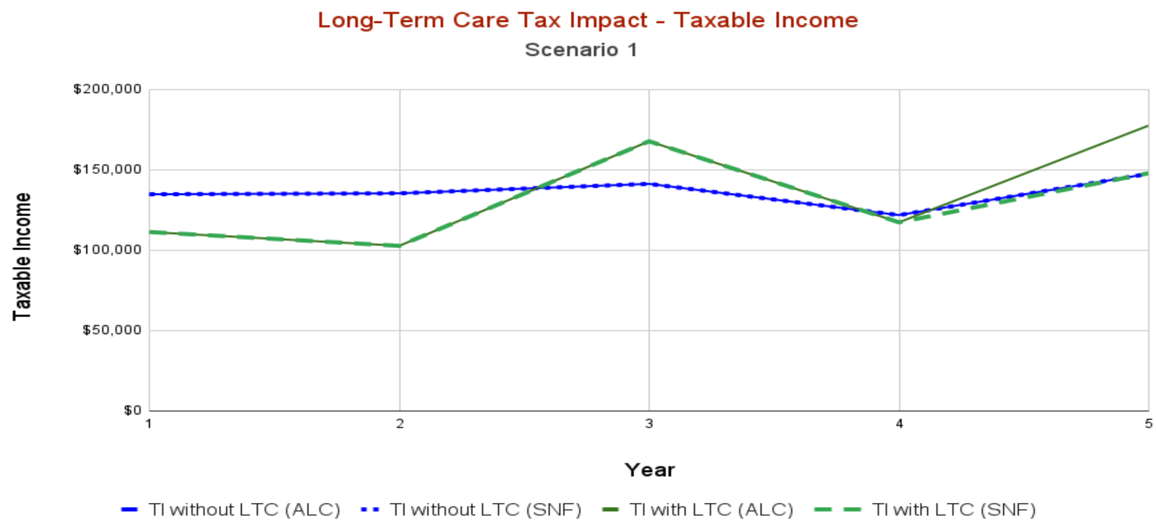
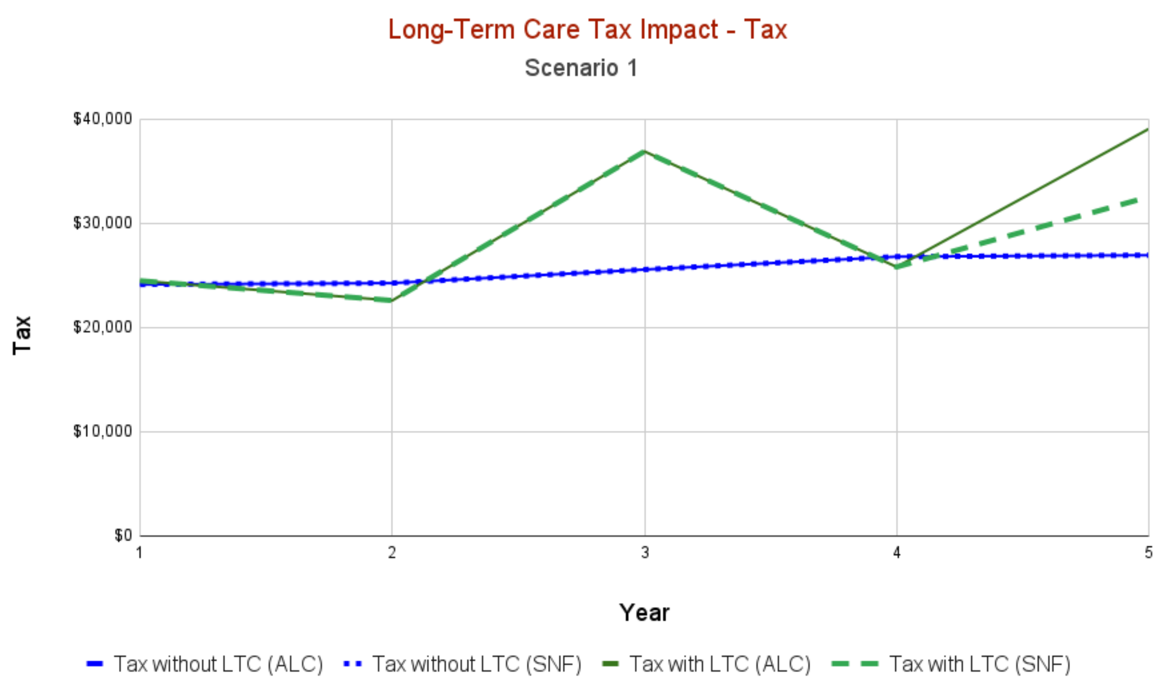


Figure 6



Taxable Income without and with LTC; Tax without and with LTC

End of Year	Taxable Income (TI) without LTC/with LTC	Tax_ without LTC/with LTC
1	$134,750/$111,256	$24,123/$24,476
2	$135,345/$102,646	$24,254/$22,582
3	$141,225/$167,738	$25,548/$36,902
4	$121,780/$117,296	$26,792/$25,805
5 (ALC)	$147,518/$177,582	$26,932/$39,068
5 (SNF)	$147,518/$147,882	$26,932/$32,534

Scenario 2, as demonstrated in figures 7 and 8 below, shows how ordinary income and income tax respond when there is no medical deduction and long-term care insurance is applied. With a long-term care insurance policy supporting the long-term care expenses, there is no need to increase ordinary income; therefore, there are no medical deductions to maintain or offset taxation. This results in higher taxation on ordinary income, a normal income tax trend, regardless of long-term care needs.

As in Scenario 1, the increased income and taxes in year 3 reflect home renovations to accommodate long-term care needs, while the return of the reimbursement cycle asset added to income, reducing the qualified distribution in year 5. Otherwise, years 3 and 5 would follow the normal path.

Figure 7

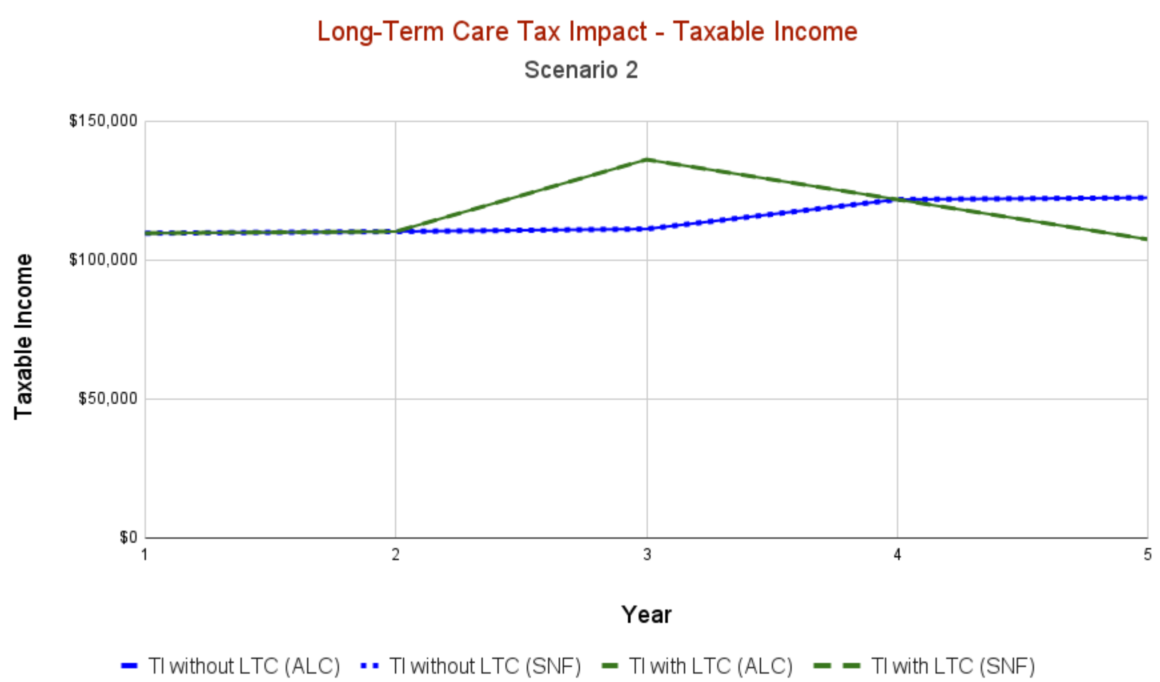
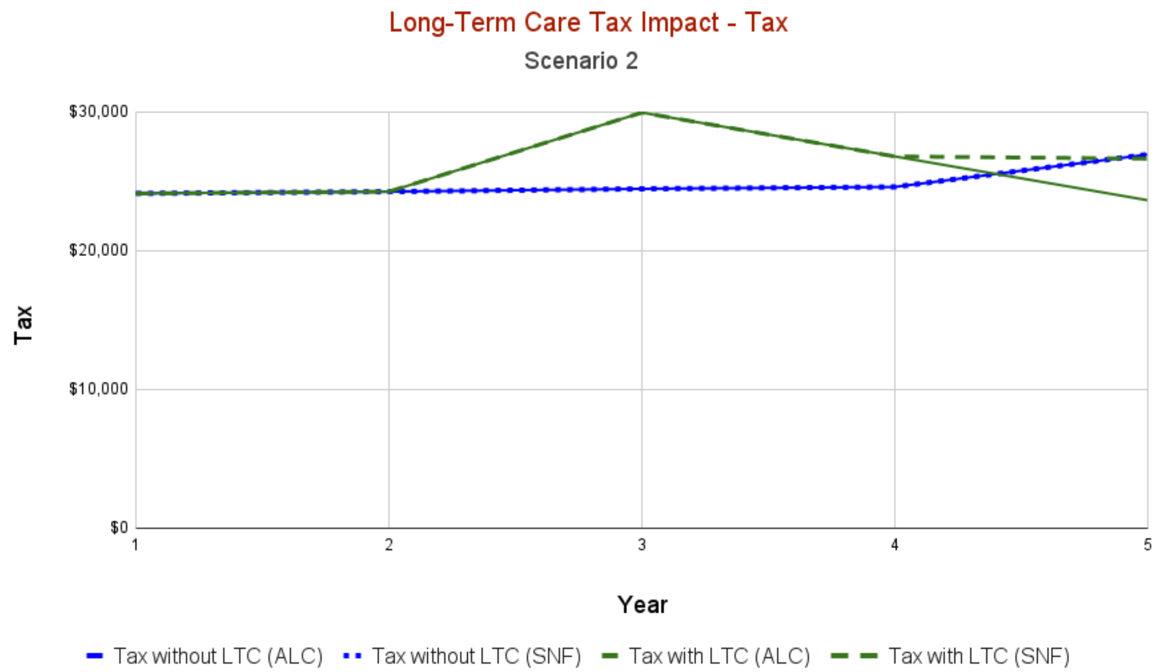


Figure 8



Taxable Income without and with LTC; Tax without and with LTC

End of Year	Taxable Income without LTC/with LTC	Tax_ without LTC/with LTC
1	$109,650/$109,650	$24,123/$24,123
2	$110,245/$110,245	$24,254/$24,254
3	$111,155/$136,155	$24,454/$29,954
4	$121,780/$121,780	$24,592/$26,792
5 (ALC)	$122,418/$107,418	$26,932/$23,632
5 (SNF)	$122,418/$107,418	$26,932/$23,632

Scenario 3 demonstrates the use of estate, financial, and long-term care planning and its tax impact. Since the potential needs were recognized early, planning was done years before long-term care was implemented.

Figures 9 and 10, below, reflect a decreasing income while needing long-term care, compared to not needing care. The income is taxed less with long-term care compared to no long-term care due to the positioning of assets over time. Notably, due to the advanced planning that was done, there is no spike in income or taxation in year 5.

Figure 9

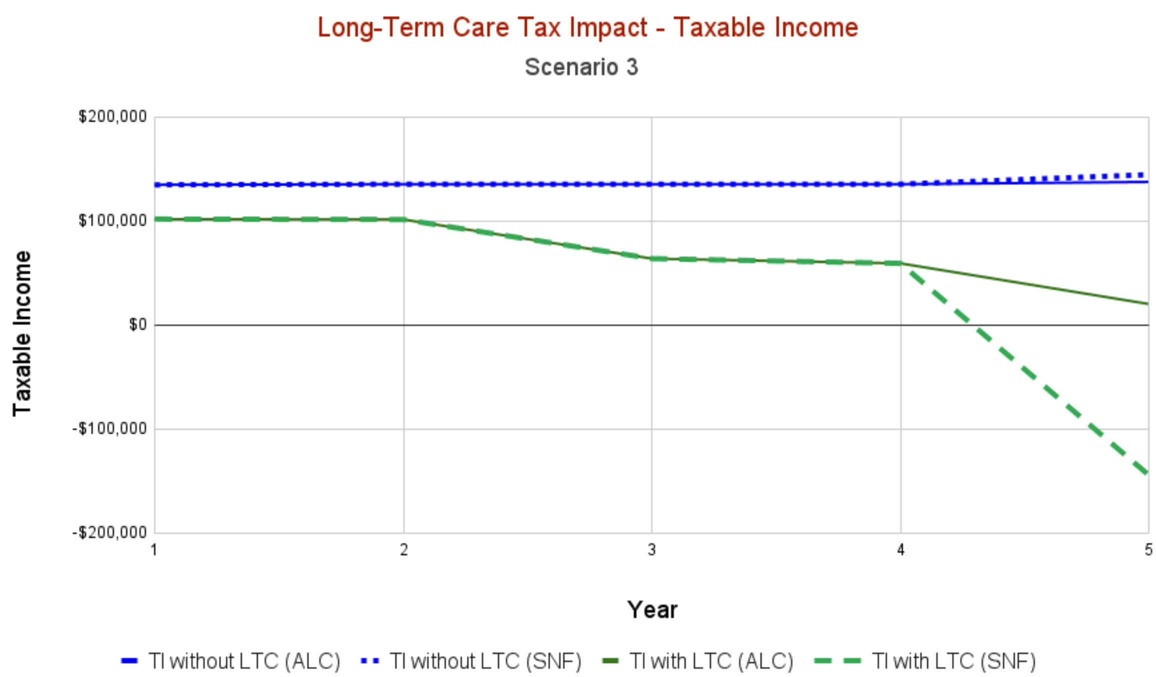
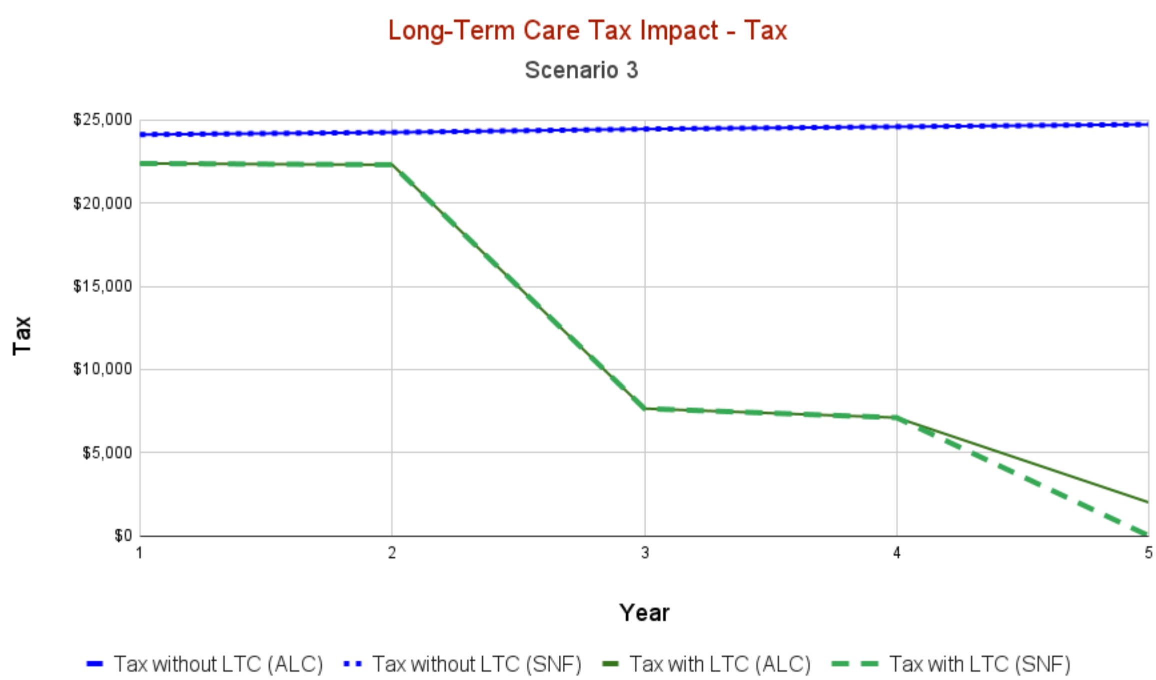


Figure 10



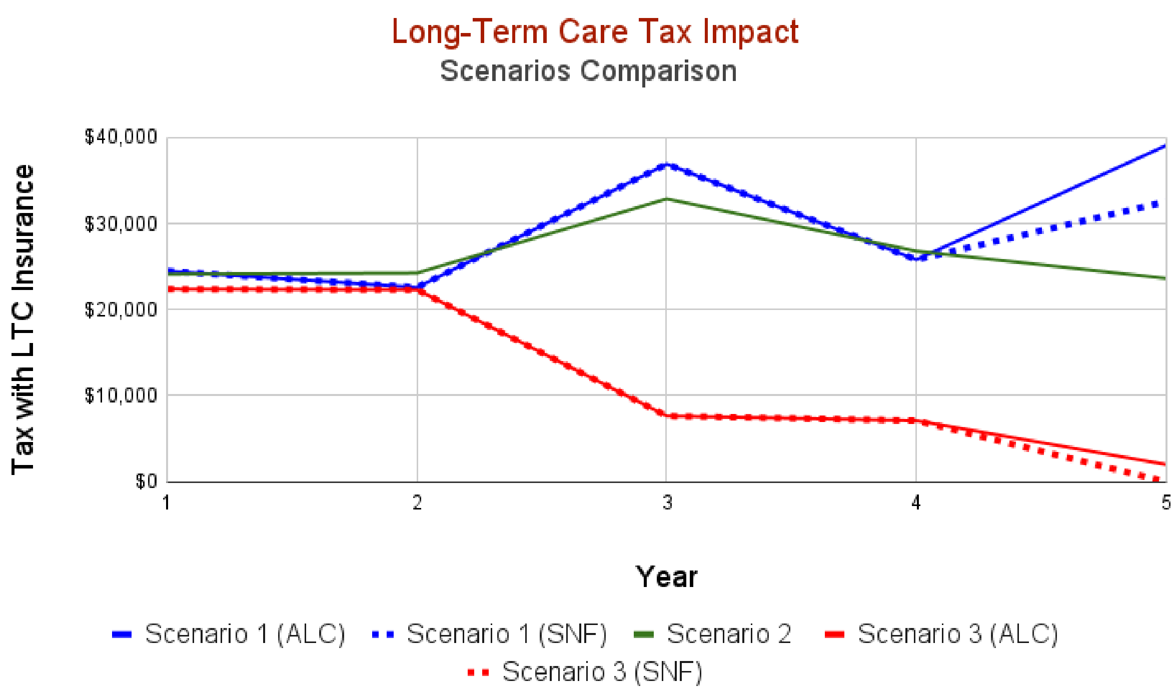
Taxable Income without and with LTC; Tax without and with LTC

End of Year	Taxable Income without LTC/with LTC	Tax without LTC/with LTC
1	$134,750/ $101,756	$24,123/$22,386
2	$135,345/ $101,396	$24,254/$22,307
3	$135,345/ $63,749	$24,454/ $7,650
4	$135,345/ $59,208	$24,592/ $7,105
5 (ALC)	$137,518/ $20,082	$24,732/ $2,008
5 (SNF)	$137,518/−$144,518	$24,732/ $0

Comparing Long-Term Care Tax Impact Scenarios

As presented in figure 11, below, when comparing the tax impact of the three scenarios, Scenario 3 has the best impact with the most planning, whereas Scenario 1 has the worst impact and very little planning. Scenario 2 is close to the impact prior to needing care and has less detailed planning than in Scenario 3.

Figure 11

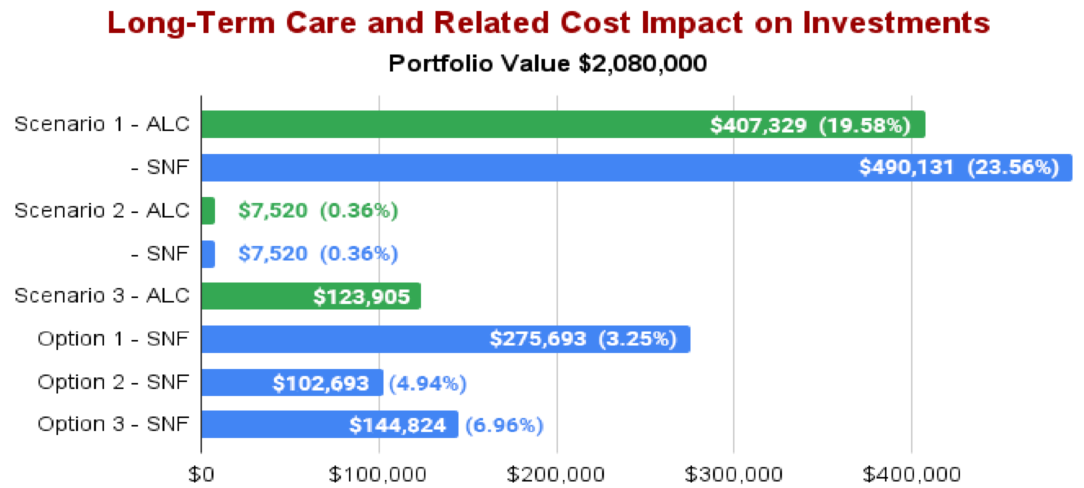


Scenario 2 demonstrates how leveraging one’s health presents a substantial opportunity when planning for long-term care. Scenario 3 demonstrates the power of planning and how it is instrumental for protecting one’s investment portfolio and minimizing income tax under certain circumstances. Scenario 1 demonstrates the pain, suffering, and bleeding one’s portfolio can experience due to long-term care needs.

Total Cost of Care Impact

Figure 12, below, represents the 5-year cost of care, present and future interest, and tax impact based on the initial investment portfolio and growth.

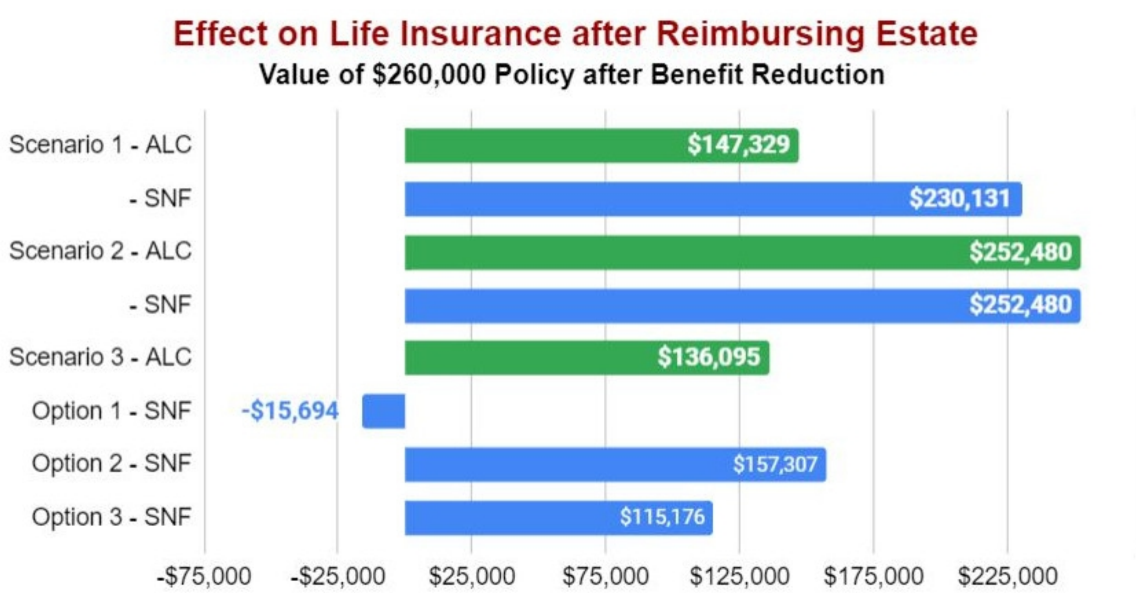
Figure 12



Impact after Life Insurance Reimburses Estate

Both John and Mary have a life insurance policy with $260,00 face values. If John died at the end of year 5, which he doesn't, his death proceed would cause the following effect, reimbursing the estate after long-term care and taxes are considered.

Figure 13.



Scenario 1

ALC would have an impact reducing the benefit to $147,329 ($260,000 − 407,329)

SNF would have an impact reducing the benefit to $230,131 ($260,000 − $490,131)

Scenario 2*

ALC would have an impact reducing the benefit to $252,480 ($260,000 − $7,520)

SNF would have an impact reducing the benefit to $252,480 ($260,000 − $7,520)

Scenario 3

ALC would have an impact reducing the benefit to $136,095 ($260,000 − $123,905)

SNF

Option 1 would have a negative impact of $15,694 ($260,000 − $275,694)

Option 2 would have an impact reducing the benefit to $157,307 ($260,000 − $102,693)

Option 3 would have an impact reducing the benefit to $115,176 ($260,000 − $144,824)

*Takes into consideration the total premium of John's long-term care insurance policy, $112,650.

Overall Results of the Study

Scenario 1 has very little planning and is most costly. Scenario 3 has sophisticated planning that takes into account the circumstances and has better outcomes than Scenario 1. Scenario 2 implements planning with insurance and creates the best scenario all around.

APPENDIX A

Scenario 1
Cost of Care, Tax, and Asset Impact Analysis

John and Mary are both 80 years old and continue to be very tax conscious. They are healthy and are enjoying their retirement. The following are their expenses, incomes, and assets.

Expenses
$130,000 a year
Throughout the study, household inflation compounds at an average of 3% a year, which is absorbed into the increase in distributions and lifestyle changes. Oftentimes people in their 80s experience a reduction in household expenses, especially when illness strikes. Their lifestyles change, and they may not be able to socialize as much or in the style they are accustomed to. Although some of their health costs increase, their total cost of living usually doesn't go up and may even go down. They stop needing two cars, go out to dinner less often, stop traveling, entertain less, eat less, and so on. For these reasons this article maintains expenses at the same value throughout the study. In a utopic world, John and Mary will have an unencumbered $10,000 at the end of the year. In a practical sense, this is absorbed by miscellaneous expenses.

Income

Social Security	$35,000 (John $23,000; Mary $12,000; 85% taxable $29,750)
John's pension	$25,000 (Spousal share if primary dies is 50%, or $12,500)
Qualified distributions	$50,000
Rental income (summer cottage)	$10,000
Non-qualified distributions	$20,000
Total income	$140,000

Adjusted gross earnings before deductions and exemptions ($25,100) is $134,750; after, with a tax rate of 22%, it is $109,650. John and Mary paid $24,123 federal tax.

Real Estate
Primary residence valued at $1.2 million in an irrevocable real estate trust.
Summer cottage valued at $800,000 in an LLC, creating the $10,000 net annual income referenced above.

Liquid Assets
- Qualified funds of $1,200,000, combined (John $800,000 and Mary $400,000)
- Roth funds of $80,000, in Mary's name
- 2 non-qualified annuities of $800,000, combined ($300,000 principal and $100,000 interest in each contract for a total of $600,000/$200,000)
- The funds grow 6% annually.

Insurance

- John and Mary each have a $250,000 permanent life insurance (total of $500,000) with a current cash value of $10,000 (total of $20,000) and an increasing death benefit option, current combined death benefit, $520,000. Although the cash value is an asset, it is not being considered in this study since it is only enough to keep the policy going to age 100.
- The policies do not offer accelerated death benefits options.

Current Tax Strategy

When John and Mary purchase something that requires more than the amount of their annual RMD, they coordinate between qualified and non-qualified accounts, sometimes including their Roth accounts to minimize their income tax. Since retired, they have been leaning heavily on their Roth accounts for travel and pleasure in order to minimize their taxes.

Medical Deductions

For the purpose of this article, although John and Mary didn't meet the IRS medical deduction guidelines while John was heathy, it is understood that the couple had qualified medical deductible expenses such as Medicare premium, supplemental health insurance premiums, copays, and mileage to and from doctor visits, hospitals, and pharmacies. These deductible expenses are purposely excluded, thus demonstrating and isolating the tax impact of the cost of long-term care.

Life-Changing Situation

While age 80, John suffers a stroke and is diagnosed with vascular dementia. John and Mary have two children, married with their own families and living out of state, unable to help. Mary is going to need help caring for John and refuses to burden their children.

The couple have no long-term care insurance; nothing is protected, other than the real estate properties. The following are the impacts to John and Mary for the five years after John's stroke.

SCENARIO 1, YEAR 1

In addition to using $70,000 (qualified distributions and non-qualified funds) to maintain the household and pay taxes, Mary spends an additional $30,000 from her pool of liquid assets for John's care, of which $20,000 is taxable. They now have $30,000 in receipts that add to their medical deductions and may help offset the tax consequences of the additional distributions.

Below, qualified distributions include RMDs. Qualified, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Liquid Assets $2,080,000

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$35,000	(85% taxable = $29,750)
Pension	$25,000	(level)
Qualified distribution	$50,000	(to meet cash needs to fund $20,000 federal tax for the prior year plus $30,000 for household expenses)
Rental income	$10,000	(after expenses)
NQ annuity	$40,000	(household use, all interest; annuity has $200,000 interest to be distributed before principal)
Roth	$10,000	
Total income	$170,000	

Household Income Used for Long-Term Care Needs

(Qualified reimbursable expenses = $30,000)

NQ annuity	$20,000	(all interest)
Roth	$10,000	

Federal Tax

AGI (adjusted gross income)	$129,650	(Taxable income = $25,000 + $50,000 + $10,000 + $40,000 + taxable SS $29,750 = $154,750; AGI = $154,750 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$18,394	($154,750 x 7.5% = $11,606; $30,000 − $11,606 qualified medical expense deduction = $18,394)
Taxable income	$111,256	($129,650 − $18,394)
Federal tax	$24,476	($111,256 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis

Without the LTC costs and an additional $20,000 withdrawal, John and Mary's taxable income would be $134,750 and cause a tax of $24,123 ($134,750 − $25,100 = $109,650; x 22% = $24,123), which is $353 less ($24,476 − $24,123) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $353 more in income tax, a negative impact.

Actual cost of care:

LTC tax impact is $353 tax cost (difference between tax with and without medical deductions, $24,476 − $24,123), although it cost $30,000 of assets.

Distributions from retirement and Roth = $30,000; interest loss on $30,000 at 6% = $1,800.

Total cost of care in the first year is **$32,153** (distribution of $30,000 + tax cost of $353 + lost interest of $1,800).

Asset Comparison

Liquid asset values going into year 1	$2,080,000
Liquid asset values going into year 2	
Qualified funds	$1,219,000*
NQ funds	$805,600**
Roth	$74,200***
Total	$2,098,800
Net asset value	$18,800 Gain

Analysis

1. Although creating more taxable income, the tax impact leaves the effective tax rate the same as the previous year ($24,476 − $24,123 = $353).
2. The cost of care reduced the portfolio by $30,000.
3. The fund reduction cost the portfolio $1,800 in potential interest.
4. Cost of care in year 1 is $32,153.
5. Overall cost of care in year 1 and to date is $32,153
6. Investment Response:
   A. *Qualified funds (Q): $1,200,000 − $50,000 = $1,150,000; plus, growth of 6% = $1,150,000 x .06 = $69,000; new balance = $1,150,000 + $69,000 = $1,219,000.
   B. **NQ: $800,000 − $40,000 taxable interest (from NQ annuities in household income and LTC needs, $20,000 each) = $760,000; growth of 6% = $45,600; new balance = $805,600.
   C. ***Roth: $80,000 − $10,000 = $70,000; plus, growth of 6%, $4,200; new balance = $74,200.

SCENARIO 1, YEAR 2

In addition to using $70,000 (qualified and non-qualified) to maintain the household and pay taxes, Mary spends $50,000 from her pool of liquid assets for John's care, of which $30,000 is taxable. They now have $50,000 in receipts that add to their medical deductions and may help offset the tax consequences of the additional distributions.

Expenses Other Than Long Term Care: $130,000 (includes inflation)
Throughout the study, household inflation continues to compound at an average of 3% a year, which is absorbed into the increase in distributions and lifestyle changes (travel and entertainment), created by John's disabilities.

Household Income

SS	$35,700	(received a 2% increase; 85% taxable = $30,345)
Pension	$25,000	
Qualified distribution	$50,000	(to meet cash needs to fund $24,062 federal tax for prior year plus $25,938 for household expenses)
Rental income	$10,000	(after expenses)
NQ annuity	$50,000	
Roth	$20,000	
Total Income	$190,700	

Household Income Used for Long-Term Care Needs
Qualified reimbursable expenses = $50,000

NQ annuity	$30,000
Roth	$20,000

Note: Within the increased cost of care lies inflation. Long-term care inflation is between 3.36 and 6.17 percent, depending on the category of services, which ranges from skilled nursing to in-home care.[6]

Federal Tax

AGI	$140,245	($165,345 taxable income − $25,100; assume itemized deductions other than medical equal standard deduction)
Medical deduction	$37,599	($165,345 x 7.5% = $12,401; $50,000 − $12,401 qualified medical expense deduction = $37,599)
Taxable income	$102,646	($140,245 − $37,599)
Federal tax	$22,582	($102,646 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
Without the LTC costs and an additional $30,000 withdrawal, John and Mary's taxable income would be $135,345 and cause a tax of $24,254 ($135,345 − $25,100 = $110,245; x 22% = $24,254), which is $1,672 more ($24,254 − $22,582) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $1,672 less in income tax, a positive impact.

Note: Personal exemptions are assumed to remain the same as in year 1, and SS increase is hypothetical.

Actual cost of care:

- LTC tax impact is $1,672 tax savings (difference between tax with and without medical deductions, $24,254 − $22,582), although it cost $50,000 in assets.
- Distributions from retirement and Roth = $50,000.
- Interest loss on $50,000 at 6% = $3,000.

Total cost of care in the second year is **$51,328.** ($50,000 + $3,000 − $1,672)

Asset Comparison

Liquid asset values going into year 1	$2,080,000
Liquid asset values going into year 2	$2,098,800

Liquid asset values going into year 3

Qualified funds	$1,239,140*
NQ funds	$800,936**
Roth	$57,452***
Total	$2,097,528

Net asset value

$1,272 reduced over l year ($2,097,528 − $2,098,800)

$17,528 gain after 2 years ($2,097,528 − $2,080,000)

Analysis

1. The tax impact due to the medical deductions offset the increased qualified distributions and reduced the effective tax rate.
2. The cost of care reduced the portfolio by $50,000.
3. The fund reduction cost to the portfolio is $3,000 in potential interest; however, the favorable tax impact offset this by $1,672, creating a difference of $1,328.
4. Cost of care in year 2 is $51,328.
5. Overall cost of care to date is $83,481.
6. Investment Response:
   A. *Q: $1,219,000 − $50,000 = $1,169,000; plus 6% growth of $70,140 gives a new balance = $1,239,140.
   B. **NQ: $805,600 − $50,000 taxable interest (from NQ annuities in household income and LTC needs) = $755,600; plus 6% growth = $45,336; new balance = $800,936.
   C. ***Roth: $74,200 − $20,000 = $54,200; plus 6% growth, $3,252; new balance = $57,452.

SCENARIO 1, YEAR 3

In addition to using $70,000 (qualified and non-qualified) to maintain the household and pay taxes, Mary spends $70,000 from her pool of liquid assets for John's care, of which $40,000 is taxable. They now have $70,000 in receipts that add to their medical deductions and may help offset the tax consequences of the additional distributions.

Mary also decides to add a first-floor bedroom and handicap bathroom to their home to accommodate John's growing disabilities. The renovation costs her $115,000. With the advice of her team of professionals, she takes $72,548 from John's qualified retirement fund, $27,452 from their Roth account, and $15,000 personal savings, keeping her tax rate at 22%. This exhausts the Roth account. The value of the liquid assets will transfer into the value of the home, realizing some of the expenses against capital gains upon the eventual sale of the home.

In total this year, Mary has used $187,548 of taxable funds, of which $80,000 in receipts will contribute to their medical deductions to help offset the tax consequences.

Expenses Other Than Long Term Care: $130,000 (includes inflation)

Household Income

SS	$36,771	(received a 3% increase; 85% taxable = $31,255)
Pension	$25,000	
Qualified distribution	$127,548	(to meet cash needs to fund $22,168 federal tax for prior year, $32,832 for household expenses, and $72,548 for renovations)

Rental income	$10,000	(after expenses)
NQ annuity	$60,000	
Roth	$57,452	
Total income	$316,771	

Household Income Used for Long-Term Care Needs

NQ annuity	$40,000	
Roth	$57,452	($30,000 annual needs plus $27,452 for renovations)
Total	$97,452	
Qualified reimbursable expenses	$80,000	($70,000 for John's care and $10,000 adaptive equipment within the renovations)

Federal Tax

AGI	$228,703	($253,803 income − $25,100; assumes itemized deductions other than medical equal standard deduction)
Medical deduction	$60,965	($253,803 x 7.5% = $19,035; $80,000 − $19,035 qualified medical expense deduction = $60,965)
Taxable income	$167,738	($228,703 − $60,965)
Federal Tax	$36,902	($167,738 x 22% effective rate; paid out of qualified funds)

Note: If Mary didn't exhaust the Roth account, her taxable income would be above the 22% tax rate, increasing it to 24%. Her tax would then be $11,306 greater.

Tax/Investment Impact Analysis

Increasing their qualified distributions to $55,000, without the LTC costs and an additional $70,000 withdrawal, John and Mary's taxable income would have been $141,225 and caused a tax of $25,548 ($141,225 − $25,100 = $116,125; x 22% = $25,548), which is $11,354 less ($36,902 – $25,548) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $11,354 more in income tax, a negative impact.

Actual cost of care without renovations:

- Distributions from retirement and Roth: $70,000 + $10,000 for adaptive equipment = $80,000.
- LTC tax impact is $11,348 additional tax (difference between tax with and without medical deductions, $36,902 − $25,554).
- Interest loss on $80,000 at 6% = $4,800.

Total cost of care in the third year is **$96,148** (cost of care, taxes, and interest lost: $80,000 + $11,348 + $4,800).

Asset Comparison

Liquid assets going into year 1	$2,080,000
Liquid assets going into year 3	$2,097,528

Liquid assets going into year 4

Qualified funds	$1,178,288*
NQ funds	$785,392**
Roth	$0
Total	$1,963,680

Net asset value

$133,848 less from year 2 ($1,963,680 − $2,097,528)
$116,320 less after 3 years ($1,963,680 − $2,080,000)

Analysis

1. By exhausting the Roth account, taxable income was maintained at a 22% tax rate and saved $11,306 in potential taxes.
2. Unlike prior years, the tax impact due to the medical deductions did not offset the increased qualified distributions and did not reduce the effective tax rate. It did the opposite; it increased the effective tax rate and taxation.
3. The cost of care reduced the portfolio by $80,000.
4. The fund reduction cost to the portfolio is $4,800 in potential interest.
5. Cost of care in year 3 is $96,148.
6. Overall cost of care to date is $179,629.
7. Investment Response:
   A. *Q: $1,239,140 − $127,548 = $1,111,592; plus 6% growth, $66,696; new balance = $1,178,288.
   B. **NQ: $800,936 − $60,000 taxable interest (from NQ annuities in household income and LTC needs) = $740,936; plus 6% growth, $44,456; new balance = $785,392.
   C. Roth: Exhausted.

SCENARIO 1, YEAR 4

In addition to using $80,000 ($60,000 qualified distributions and $20,000 non-qualified distributions) funds to maintain the household and pay taxes, Mary spends $60,000 (non-qualified distributions) from her pool of liquid assets for John's care, of which $60,000 is taxable. The $60,000 is assumed to be qualified medical expense, which allows 40 hours of care at a rate of $30 per hour. Mary plans to have someone with John 5 to 6 hours a day, 7 days a week. This will allow her to do what she needs to do for herself and maintain the household. They now have $60,000 in receipts that add to their medical deductions and may help offset the tax consequences of the additional distributions.

Expenses Other Than Long-Term Care: $130,000 (includes inflation)

Household Income

SS	$37,506	(received a 2% , or $735, increase; 85% taxable = $31,880)
Pension	$25,000	
Qualified distribution	$60,000	(to meet cash needs to fund $36,488 federal tax for prior year plus $23,512 for household expenses)
Rental income	$10,000	(after expenses)

NQ annuity	$80,000	($20,000 household + $60,000 John's care)
Total Income	$212,506	

Household Income Used for Long-Term Care Needs
NQ annuity $60,000
Qualified medical deduction expenses $60,000

Federal Tax

AGI	$181,780	($206,880 income − $25,100; assuming itemized deductions other than medical equal standard deductions)
Medical deduction	$64,484	($206,880 x 7.5% = $15,516; $80,000 − $15,516 qualified medical expense deduction = $64,484)
Taxable income	$117,296	($181,780 − $64,484)
Federal tax	$25,805	($117,296 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
Increasing their qualified distribution to $80,000, without the LTC costs, their taxable income would be $121,780 and cause a tax of $26,792 ($146,880 − $25,100 = $121,780; x 22% = $26,792), which is $987 more ($26,792 − $25,805) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $987 less in income tax, a positive impact.

Actual cost of care:

- LTC tax impact is $987 tax savings (difference between tax with and without medical deductions, $25,805 − $26,792), although it cost $60,000 of assets.
- Distribution from NQ account is $60,000.
- Interest loss on $60,000 at 6% = $3,600.

Total cost of care in year 4 is **$62,613** (distribution of $60,000 cost of care + $3,600 interest lost − $987 tax savings).

Asset Comparison

Liquid assets going into year 1	$2,080,000
Liquid assets going into year 4	$1,963,680
Liquid assets going into year 5	
Qualified funds	$1,185,385*
NQ funds	$747,716**
Total	$1,933,101

Net assets
$30,579 reduced from year 3 ($1,933,101 − $1,963,680)
$146,899 reduced after 4 years ($1,933,101 − $2,080,000)

Analysis

1. As in year 2, the tax impact due to the medical deductions offset the increased qualified distributions.

2. The cost of care reduced the portfolio by $60,000.
3. The fund reduction cost to the portfolio is $3,600 in potential interest.
4. Overall cost of care in year 4 is $62,613.
5. Overall cost of care to date is $242,242
6. Investment Response:
   A. *Qualified funds: $1,178,288 − $60,000 = $1,118,288; plus, growth of 6%, $67,097; new balance = $1,185,385.
   B. **NQ: $785,392 − $80,000 taxable interest (from NQ annuities in household income and LTC needs) = $705,392; plus 6% growth, $42,324; new balance = $747,716.

SCENARIO 1, YEAR 5

This scenario presents two options beyond caring for John at home: 5A – assisted living community (ALC) and 5B – skilled nursing facility (SNF).

John's memory is getting worse. He fails more frequently to recognize Mary, which is emotionally draining for Mary, and he's beginning to wander at night. Mary finds it difficult to sleep. Caring for him, even with the extra care on weekends, is difficult at home. Fearing for her own health, she has three options: continue caring for him at home with added help and safeguarding John in the home, placing him in a memory care unit within an assisted living community, or placing him in a nursing home.

5A – Assisted Living Community (ALC)

In this scenario, John fit the criteria for the assisted living community, which presents an environment that is less medical and more of a normal style of living. Mary decides to place John in the assisted living community (ALC).

The additional cost above the $60,000 she spent last year for John's care is $48,000 a year, or $108,000 in total, of which $72,000 is considered a medical deduction and $36,000 represents rent, food, and several other accommodations that do not qualify as medical deductions.

Along with the cost of care, Mary will need $80,000 for her pool of assets to pay for household expenses and income tax as in previous years. Regardless of what fund she takes the money from, she will pay income tax on the distribution. She decides to take the entire amount from her qualified asset. She takes a distribution of $188,000.

Expenses Other Than Long-Term Care: $130,000 (includes inflation)

Household Income

SS	$38,256	(reflects a 2%, or $750, increase; 85% taxable = $32,518)
Pension	$25,000	
Qualified distribution	$188,000	(to meet cash needs to fund $54,195 federal tax for prior year plus $25,805 for household expenses and $108,000 for John's care)
Rental income	$10,000	(after expenses)
Total Income	$261,256	

Household Income Used for Long-Term Care Needs

Qualified funds $108,000

Qualified medical deduction expenses $72,000

Federal Tax

AGI	$230,418	$255,518 ($32,518 + $25,000 + $188,000 + $10,000) income − $25,100; assuming itemized deductions other than medical equal standard deductions)
Medical deduction	$52,836	($255,518 x 7.5% = $19,164; $72,000 − $19,164 qualified medical expense deduction = $52,836)
Taxable income	$177,582	($230,418 − $52,836)
Federal tax	$39,068	($177,582 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis - ALC

Mary maintains her qualified distribution to $80,000. Without the LTC costs, their taxable income would be $147,518 ($32,518 + $25,000 + $80,000 + $10,000) and cause a tax of $26,932 ($147,518 − $25,100 = $122,418; x 22% = $26,932), which is $12,136 less ($39,068 − $26,932) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $12,136 more in income tax, a negative impact.

Actual cost of care:

- LTC tax impact is $12,136 income tax increase (difference between tax with and without medical deductions, $39,068 − $26,932).
- Distributions from qualified account for LTC is $108,000.
- Interest loss on $108,000 at 6% = $6,480.

Total cost of care using an ALC in year 5 is **$102,344** ($108,000 for care plus $6,480 lost in potential interest minus $12,136 more paid in income tax).

Asset Comparison

Liquid assets going into year 1	$2,080,000
Liquid assets going into year 5	$1,933,101
Liquid assets going into year 6	
Taxable qualified fund	$1,065,407*
NQ fund	$792,579**
Total	$1,857,986

Net assets

$75,115 reduced from prior years ($1,857,986 − $1,933,101

$222,014 reduced after 5 years ($1,857,986 − $2,080,000)

Analysis

1. The tax impact due to the medical deductions **does not** offset the increased qualified distributions as in years 2 and 4. Tax impact was an increase of $9,936.
2. Overall cost of care in year 5 using an ALF is $102,344.

3. Cost of care after 5 years is $344,586.
4. The cost of care reduced the portfolio by $222,014 ($2,080,000 − $1,857,986).
5. The 6% inflation rate for LTC and health care offsets any interest growth.
6. The $80,000 a year to maintain Mary's household plus qualified distributions of $108,000 gives a total of $188,000. Her fund will be reduced to $130,320 (community spouse allowance) within 10 years ($1,857,986 − $130,320 = $1,727,666; $1,727,666 divided by $188,000 per year = 9.2 years).
7. Mary, without needing care for herself, will have exhausted their liquid assets at age 94 or sooner if they reside in a state that has state income tax.
8. If Mary needs help for herself, the funds will be reduced more dramatically to cover care expenses for both John and Mary. If John goes to a nursing home, Mary may go to an assisted living community, splitting them up. It that were to take place, their assets would be spent down while in they are in their 80s.
9. Investment Response:
    A. *Q: $1,193,101 – $188,000 ($80,000 + $108,000) = $1,005,101; growth of 6%, $60,306 = $1,065,407.
    B. **NQ: $747,716, plus, growth of 6%, $44,863; new balance = $792,579.

Effects of ALC

Five Year Long-Term Care Investment Impact

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$30,000	$1,800 x 5 yrs. =	$9,000	$540 x 5 yrs. = $2,700
2	$50,000	$3,000 x 4 yrs. =	$12,000	$720 x 4 yrs. = $2,880
3	$80,000	$4,800 x 3 yrs. =	$14,400	$864 x 3 yrs. = $2,592
4	$60,000	$3,600 x 2 yrs. =	$7,200	$252 x 2 yrs. = $504
5	$108,000	$6,480 x 1 yr. =	$6,480	$389 x 1 yr. = $389
Total	**$328,000**	**$19,680***	**$49,080**	**$9,065**

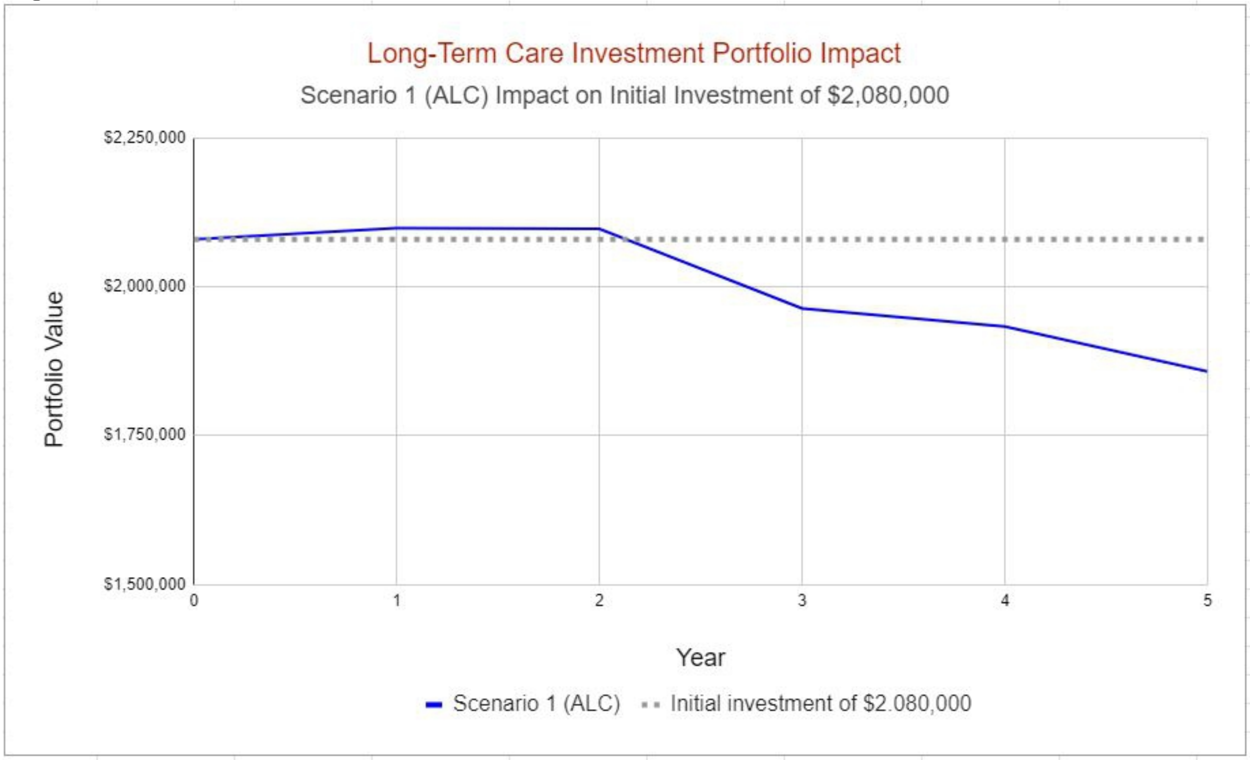
*Interest represented in Scenario 1, years 1-5.

Five Year Impact of Long-Term Care on Taxable Income and Tax

End of Year	Taxable Income without/with LTC	Tax without/with LTC	Tax Difference	Impact
1	$134,750/$111,256	$24,123/$24,476	+$353	Negative
2	$135,345/$102,646	$24,254/$22,582	−$1,672	Positive
3	$141,225/$167,738	$25,548/$36,902	+$11,354	Negative
4	$115,415/$117,296	$26,792/$25,805	−$987	Positive
5	$147,518/$177,582	$26,932/$39,068	+$12,136	Negative
Total			**+$21,184**	Negative

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $407,329 ($328,000 + $49,080 + $9,065 + $21,184), or 19.58%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be 39.17%. If their portfolio was $500,000, they would have spent 81.46% of their liquid assets and potentially be forced to sell their real estate and possibly end up in a nursing home on Medicaid in the 6th year. The negative impact puts the value of the portfolio below where it was when John first needed care.

Figure 14



Taxable income and income tax caused by home renovation and modification created a spike in year 3.

<u>5B − Skilled Nursing Facility (SNF)</u>

John's medical evaluation isn't conducive to an assisted living community, and he is placed in a skilled nursing facility, otherwise referred to as a nursing home.

Mary uses $80,000 (RMD) to maintain the household and pay taxes. John's health has regressed, and Mary is emotionally disturbed watching him decline. Concerned for her own emotional and physical health at age 85, she is forced to put him in a memory care unit within a skilled (nursing home) facility. Cost of care is $16,000 a month, $192,000 a year. In meeting with the nursing facility, Mary learned they can help her apply for Medicaid once John and Mary's countable assets are reduced to $137,400 (2022 figure). They now have $192,000 in nursing home bills that add to their medical deductions and may help offset the tax consequences of the additional distributions.

Expenses Other Than Long-Term Care: $130,000 (includes inflation)

Household Income

SS	$38,256	(reflects a 2%, or $750, increase; 85% taxable = $32,518)
Pension	$25,000	
Qualified distributions	$192,000	(to meet cash needs to fund $25,391 federal tax for prior year plus $24,609 for household expenses)
Rental income	$10,000	(after expenses)
NQ annuity	$80,000	
Total Income	$345,256	

Household Income Used for Long-Term Care Needs

$16,000 x 12 months =	$192,000
NQ annuity funds	$60,000
Qualified funds	$132,000

Qualified medical deduction expenses $192,000

Federal Tax

AGI	$314,418	($339,518 taxable income − $25,100; assumes itemized deductions other than medical equal standard deduction)
Medical deduction	$166,536	($339,518 x 7.5% = $25,464; $192,000 − $25,464 qualified medical expense deductions = $166,536)
Taxable income	$147,882	($314,418 − $166,536)
Federal tax	$32,534	($147,882 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis − SNF
Increasing their qualified distributions to $80,000, without the LTC costs, taxable income would be $147,518 and cause a tax of $26,932 ($147,518 − $25,100 = $122,418; x 22% = $26,932), which is $5,602 more ($26,932 − $32,534) than what they paid with the LTC costs included. That is, the LTC costs result in their paying $5,602 more in income tax, a negative impact.

Actual cost of care:

- LTC tax impact is $5,602 tax increase (additional tax liability, difference between tax with and without medical deductions, $32,534 − $26,932).
- Distributions from qualified accounts for LTC is $192,000.
- Interest loss on $192,000 at 6% = $11,520.

Total cost of care in year 5 is $209,122 ($192,000 for care + $11,520 lost in potential interest + $5,602 more paid in income tax).

Overall cost of care to date is **$451,364.**
Asset Comparison

Liquid assets going into year 1	$2,080,000
Liquid assets going into year 5	$1,933,101

Liquid assets going into year 6

Taxable qualified fund	$1,052,988*
NQ funds	$707,779**
Total	$1,760,767

Net assets

$172,334 reduced from prior years ($1,760,767 − $1,933,101)
$319,233 reduced after 5 years ($1,760,767 − $2,080,000)

Analysis

1. The tax impact due to the medical deductions **does not** offset the increased qualified distributions as in years 2 and 4. Tax impact was an increase of $5,602.
2. Overall cost of care in year 5 is $209,122.
3. Cost of care after 5 years is $451,364.
4. The cost of care reduced the portfolio by $319,233 ($2,080,000 − $1,760,767), not taking into consideration potential interest that could have accumulated.
5. The 6% inflation rate for LTC and health care offsets any interest growth. The $80,000 a year to maintain Mary's household plus qualified medical deduction expenses of $192,000 gives a total of $272,000. Her fund will be reduced to $130,320 (community spouse allowance) within 5 to 6 years ($1,674,776 − $130,320 = $1,554,456; $1,554,456 divided by $272,000 per year = 5.7 years). Mary, without needing care for herself, will have exhausted their liquid assets at age 91 or sooner if they reside in a state that has state income tax.
6. If Mary needs help, the funds will be reduced more dramatically to cover care expenses for both John and Mary. While John may go to a nursing home, Mary may go to an assisted living community, splitting them up. It that were to take place, their assets would be spent down while in they are in their 80s.
7. Investment Response:
   A. *Q: $1,185,385 – $192,000 ($60,000 + $132,000) = $993,385; plus growth of 6% ($59,603) = $1,052,988.
   B. **NQ: $747,716 − $80,000 taxable interest (from NQ annuities in household income and LTC needs) = $667,716; plus growth of 6% ($40,063) = $707,779.

Effects of SNF

Five Year Long-Term Care Investment Impact

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$30,000	$1,800 x 5 yrs. =	$9,000	$540 x 5 yrs. = $2,700
2	$50,000	$3,000 x 4 yrs. =	$12,000	$720 x 4 yrs. = $2,880
3	$80,000	$4,800 x 3 yrs. =	$14,400	$864 x 3 yrs. = $2,592
4	$60,000	$3,600 x 2 yrs. =	$7,200	$252 x 2 yrs. = $504
5	$192,000	$11,520 x 1 yr. =	$11,520	$691 x 1 yr. = $691
Total	**$412,000**	**$24,720***	**$54,120**	**$9,367**

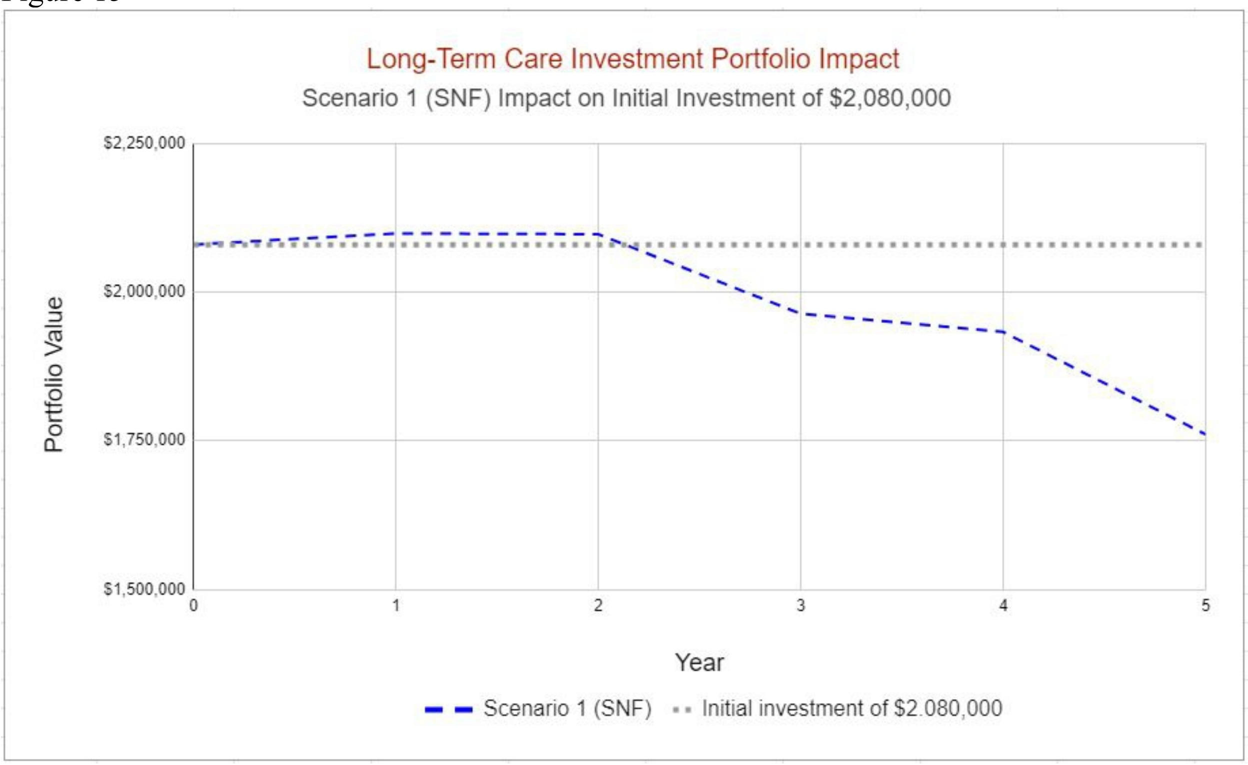
*Interest represented in Scenario 1, years 1-5

Five Year Impact of Long-Term Care on Taxable Income and Tax

End of Year	Taxable Income without/with LTC	Tax without/with LTC	Tax Difference	Impact
1	$134,750/$111,256	$24,123/$24,476	+$353	Negative
2	$135,345/$102,646	$24,254/$22,582	−$1,672	Positive
3	$141,225/$167,738	$25,554/$36,902	+$11,348	Negative
4	$115,415/$117,296	$26,792/$25,805	−$987	Positive
5	$147,415/$147,882	$26,932/$32,534	+$5,602	Negative
Total			+**$14,644**	Negative

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $490,131 ($412,000 + $54,120 + $9,367 + $14,644), or 23.56%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be 47%. If their portfolio was $500,000, they would have spent all their liquid assets, be forced to sell their real estate, and possibly end up in a nursing home on Medicaid. The negative impact puts the value of the portfolio below where it was when John first needed care.

Figure 15



Taxable income and income tax caused by home renovation and modification created a spike in year 3.

APPENDIX B

Scenario 2
Impact Analysis of Costs of Care, Taxes, and Assets

John and Mary have long-term care insurance, and everything possible is legally protected to the best of their ability. The following are the impacts to John and Mary for the five years after John's stroke.

John's long-term care insurance policy can be used for home health care, for adult day care, or to help pay for assisted living or care in a skilled nursing facility. The benefit pool has grown to $699,052 and can reimburse costs up to $19,419 monthly, of which $3,883.80 can be used for incidentals outside the levels of care listed above. If Mary spends more than $19,419 in any month, the excess will not be reimbursed. If she spends $19,419 each month, the benefit pool will last 3 years. If she spends less, the pool will last until the entire benefit pool of $699,052 is exhausted. If John exhausts his benefits, Mary can decide whether she wants to share a portion of her benefits with John, lengthening his reimbursement period. John elected the option avoiding an elimination period for home health care; because he is going to be cared for at his home, the 90-day elimination period is waived. The elimination period will take place only if John enters an assisted living or skilled nursing facility, without being cared for at home first or in a rehabilitation facility. If John is admitted to a rehabilitation facility, Medicare and his supplemental health insurance may fulfill all or part of the elimination period obligation.

The following is John and Mary's financial status upon entering long-term care.

<u>Expenses</u>
$130,000 a year.

<u>Income</u>

Social Security	$35,000 (John $23,000; Mary $12,000)
John's pension	$25,000 (Spousal share if primary dies is 50%, or $12,500)
Qualified distribution	$70,000
Rental income (summer cottage)	<u>$10,000</u>
Total income	$140,000

In a utopic world, John and Mary will have an unencumbered $10,000 at the end of the year. In a practical sense, this is absorbed by miscellaneous expenses.

<u>Real Estate</u>

- Primary residence valued at $1.2 million in an irrevocable real estate trust.
- Summer cottage valued at $800,000 in an LLC, creating the $10,000 annual income referenced above.

Liquid Assets

- 401(k) funds of $1,200,000, combined (John $800,000 and Mary $400,000) Retirement plan trusts have been established for John and Mary individually.
- Roth funds of $80,000, combined to be used as needed.
- This allows Mary access to $1,280,000.

Protected Assets

- 2 non-qualified annuities of $800,000, combined ($300,000 principal and $100,000 interest in each contract for a total of $600,000/$200,000) are protected in a Medicaid trust.
- The funds grow 6% annually.

Insurance

- Life insurance: John and Mary each have a $250,000 permanent life insurance (total of $500,000) with a current cash value of $10,000 (total of $20,000) and an increasing death benefit option, giving a current combined death benefit of $520,000. Although the cash value is an asset, it is not being considered in this study since it is only enough to keep the policy going to age 100. The policies do not offer accelerated death benefits options.
- Long-term care insurance as explained above with a benefit pool of $699,052 and a monthly benefit of $19,419.
- Health insurance: Because of John's illness, they changed John's health insurance programs to one that is more suitable. Even though he is paying a higher premium, the copays (hospital, doctor, and medicine) are 100% covered and offset the increased premium in a favorable way for the couple, creating relatively no strain on their household budget.

Current Tax Strategy (Similar to that in Scenario 1)
John and Mary take more than their RMDs annually. In order to minimize their income tax, when they purchase something that requires more than the amount of their qualified distribution, they coordinate between their qualified and Roth accounts. Since retired, they have been leaning heavily on their Roth accounts for travel and pleasure in order to minimize their taxes. This will now be used to accommodate John's needs outside the long-term care insurance.

Life-Changing Situation (Same as in Scenario 1)
At age 80, John suffers a stroke and is diagnosed with vascular dementia. John and Mary have two daughters, married with their own families and living out of state, unable to help. Mary is going to need help caring for John.

The following are the impacts to John and Mary for five years after John's stroke.

SCENARIO 2, YEAR 1

Mary uses $70,000 (qualified distribution) to maintain the household and pay taxes as usual.

Since it's Mary's decision to care for John at home and he has a long-term care insurance policy with a waiver of elimination period for home health care, Mary uses her personal, cash on hand/household money to help pay for John's care. His care in the first year is $30,000, averaging $2,500 a month. Based on John's monthly LTC benefit, Mary is able to take the funds from her household budget since she is reimbursed by the insurance company for the receipts in a reasonable time. She submits her receipts at the end of each month and receives the reimbursement approximately 30 days later. She has $5,000 cycling over 60 days.

Below, the qualified RMDs, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Liquid Assets $2,080,000

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$35,000	(85% taxable = $29,750)
Pension	$25,000	(level)
Qualified distribution	$70,000	(to meet cash needs to fund $20,000 federal tax for the prior year plus $30,000 for household expenses)
Rental income	$10,000	(after expenses)
Roth distribution	$5,000	(John's LTC reimbursement, a non-interest-earning cycle asset)
Total Income	$145,000	

Household Income Used for Long-Term Care Needs

One-time expenses used to create the LTCI reimbursement cycle = $5,000 (Roth distribution)

Long-Term Care Insurance

Expenses	$30,000
Reimbursement	$30,000

Federal Tax

AGI (adjusted gross income)	$109,650	($134,750 income − $25,100; standard deduction)
Medical deduction	$0	(specific to John's LTC)
Taxable income	$109,650	($109,650 − $0)
Federal tax	$24,123	($109,650 x 22%, effective rate)

Tax/Investment Impact Analysis
Since John has long-term care insurance, he has no medical deductions, so his taxable income remains the same ($109,650) as expected before he became ill. The benefits reimbursing his LTC bills are not taxable as ordinary income.

Actual cost of care:
There is no negative LTC tax impact due to John's illness. The $30,000 for his care was reimbursed by the insurance company and is not taxable. The $5,000 taken from the Roth account is not taxable. The investment portfolio experienced a $5,000 reduction, which created a $300 potential interest loss.

Total cost of care from assets in the first year is **$5,000.**

Asset Comparison

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 2		
401(k)	$1,219,000*	
Roth	$79,500**	
Total		$1,298,500
Protected assets		
Non-qualified (NQ) funds		$826,800***
Total assets		$2,125,300 (excludes $5,000 cycling asset)

Net assets after year 1 **$45,300 Gain** ($2,125,300 − $2,080,000)

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052

Analysis
1. John's long-term care needs have not caused any additional tax impact.
2. The cost of care has a $5,000 negative impact on their investment portfolio, although it is being reimbursed.
3. Because the cost of John's care was reimbursed, the portfolio grew.
4. Cost of care to the portfolio is $5,000 in year 1.
5. Overall cost of care in year 1 and to date is $5,000.
6. Investment Response:
   - A. *Q: $1,200,000 − $50,000 = $1,150,000; plus growth of 6% = $1,150,000 x .06 = $69,000; new balance = $1,150,000 + $69,000 = $1,219,000.
   - B. **Roth: $80,000 − $5,000 distributions + growth of 6%, $4,500; new balance = $79,500.
   - C. ***NQ: $800,000 − $20,000 taxable interest (from NQ annuities in household income) = $780,000; growth of 6% = $46,800; new balance = $826,800.
   - D. **$45,300 investment gain**
7. Long-term care benefit value response: benefit pool balance = $669,052

SCENARIO 2, YEAR 2

In addition to using $70,000 (qualified) to maintain the household and pay taxes, Mary spends $50,000 from John's long-term care benefit pool.

Expenses Other Than Long Term Care: $130,000 (includes inflation)
Throughout the study, household inflation continues to compound at an average of 3% a year, which is absorbed into the increase in distributions and lifestyle changes (travel and entertainment), created by John's disabilities.

Household Income going into year 2

SS	$35,700	(received a 2% increase; 85% taxable = $30,345)
Pension	$25,000	
Qualified distribution	$70,000	(to meet cash needs to fund $24,123 federal tax for prior year plus $25,877 for household expenses)
Rental income	$10,000	(after expenses)
Roth	$0	
Total Income	$140,700	

Household Income Used for Long-Term Care Needs $0

Federal Tax

AGI	$110,245	($135,345 income − $25,100 standard deduction)
Medical deduction	$0	(Specific to John's LTC)
Taxable income	$110,245	
Federal tax	$24,254	($110,245 x 22%, effective rate)

Tax/Investment Impact Analysis
Without the LTC costs, John and Mary's taxable income of $110,245 causes a tax of $24,254 ($135,345 − $25,100 = $110,245 x 22%). Tax increased $131 due to increase in SS, which is considered normal ($24,254 − $24,123 from Scenario 2, Year 1).

Note: Personal exemptions are assumed to remain the same as in year 1, and SS increase is hypothetical.

Actual cost of care: $50,000, which was reimbursed by the LTCI policy.

Portfolio impact: $0. The LTCI had a positive impact since it allowed the funds to continue to grow.

Tax impact: there was neither negative nor positive tax impact due to the cost of care.

Total cost of care from assets in the second year is **$0.**

<u>Asset Comparison</u>

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 2	$2,125,300	
Liquid assets going into year 3		
Qualified funds	$1,239,140*	
Roth	$84,270**	
Total		$1,323,410
Protected assets		
NQ funds		$855,208***
Total assets		$2,178,618 (excludes $5,000 cycling asset)

Net asset value

$53,318 gain over l year ($2,178,618 − $2,125,300)

$98,618 gain after 2 years ($2,178,618 − $2,080,000)

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052
2	$669,052	$50,000	$619,052
Total		$80,000	

Analysis

1. The tax impact was nonexistent. There are no medical deductions and no increased qualified distributions to offset. The effective tax rate remains the same.
2. The cost of care did not reduce the portfolio
3. There was no interest lost due to long-term care costs; loss was due only to RMD and normal, scheduled, additional qualified distributions.
4. Cost of care in year 2 is $50,000, reimbursed by the LTCI company.
5. Overall cost of care to date from the investment portfolio is $5,000 plus potential interest loss.
6. Investment Response:
    A. *Qualified funds: $1,219,000 − $50,000 = $1,169,000; plus 6% growth of $70,140; new balance = $1,239,140.
    B. **Roth: $79,500 − $0 (no distributions); plus 6% growth, $4,770; new balance = $84,270.
    C. ***NQ: $826,800 − $20,000 taxable interest (from NQ annuities in household income) = $806,800; plus 6% growth = $48,408; new balance = $855,208.

<u>SCENARIO 2, YEAR 3</u>

In addition to using $70,000 (qualified) to maintain the household and pay taxes, Mary spends $70,000 from her reimbursable long-term care benefit pool for John's care. They have no medical deductions to help offset the tax consequences caused by John needing care.

Mary also decides to add a first-floor bedroom and handicap bathroom to their home to accommodate John's growing disabilities. The renovation costs her $115,000. With the advice of her team of professionals, she takes $15,000 from John's long-term care (cash indemnity) insurance policy for handicap home modifications, $60,000 from their Roth account, and $40,000 from their qualified accounts, keeping her effective tax rate at 22%. The value of the liquid assets will transfer into the value of the home, realizing some of the expenses against capital gains upon the eventual sale of the home.

Expenses Other Than Long-Term Care: $130,000 (includes inflation)

Household Income

SS	$36,771	(received a 3% increase; 85% taxable = $31,255)
Pension	$25,000	
Qualified distribution	$95,000	(to meet cash needs to fund $24,254 federal tax for prior year, $30,746 for household expenses, and $40,000 for renovations)
Rental income	$10,000	(after expenses)
Roth	$60,000	(home renovation)
Total income	$226,771	

Household Income Used for Long-Term Care Needs (includes inflation)

Roth	$60,000	(home renovations, add to real estate value)

Federal Tax

AGI	$136,155	($161,255 − $25,100 standard deduction)
Medical deduction	$0	(Specific to John's LTC)
Taxable income	$136,155	
Federal Tax	$29,954	($136,155 x 22% effective rate)

Note: By coordinating the Roth account with the qualified distributions, their taxable income maintains a consistent rate and adds tax-free value to the home, which can also help offset capital gains when the home is sold.

Tax/Investment Impact Analysis

If John and Mary continued to use $70,000 (qualified) to support their household and pay income tax, without the need to expand their home for John's care, John and Mary's taxable income of $111,155 ($31,255 + $25,000 + $70,000 + $10,000 = $136,255; − $25,100) would cause a tax of $24,454 ($111,155 x 22%).

Actual cost of care to the investment portfolio without renovations is $0.

John's need for care forced the couple to expand their home, causing a $40,000 taxable qualified distribution and a $60,000 non-taxable Roth distribution and increasing the property value. The expansion cost will be recovered when the property is sold.

Interest consequences due to the renovations are as follows.

Qualified taxable distribution caused $1,500 ($25,000 x 6%) of lost potential interest.
Roth distribution caused $3,600 ($60,000 x 6%) of lost potential interest.
The tax impact is $5,500 more in taxes when comparing tax with and without LTC costs, causing a positive effect ($29,954 − $24,454).

Asset Comparison

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 3	$2,184,236	
Liquid assets going into year 4		
Qualified funds	$1,212,788*	
Roth	$25,726**	
Total		$1,238,514
Protected assets		
NQ funds		$885,320***
Total assets		$2,123,834 (excludes $5,000 cycling asset)

Property value increased with the renovations, paid through the investment portfolio.

Net assets

$60,402 reduced from year 3 ($2,123,834 − $2,184,236)

$43,834 gain after 4 years ($2,123,834 − $2,080,000)

Over three years, the portfolio continues to experience a gain, regardless of the depletion of the Roth account.

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052
2	$669,052	$50,000	$619,052
3	$619,052	$85,000	$534,052
Total		**$165,000**	

Analysis

1. The tax impact is controlled; however, it has a negative effect of $5,500 more in income tax. The medical deductions and Roth distributions helped offset the increased qualified distribution, maintaining the effective tax rate.
2. The cost of care reduced the portfolio $54,787; however, the portfolio maintained overall growth.
3. There was interest lost due to the renovation, RMD, and normal, scheduled, additional qualified distributions and not due to long-term care costs.
4. The Roth was used to add value to the home while accommodating John’s needs.
5. Cost of care in year 3 is $85,000, reimbursed by the LTCI company, of which $15,000 added to the value of the home.
6. Overall cost of care to date from the investment portfolio is $5,000.

7. Investment Response:
   A. *Q: $1,239,140 − $95,000 = $1,144,140; plus 6% growth of $68,648; new balance = $1,212,788.
   B. **Roth: $84,270 − $60,000 (home renovations, increase property value) = $24,270 + $1,456 (24,270x 6%) interest = $25,726.
   C. ***NQ: $855,208 − $20,000 taxable interest (from NQ annuities in household income) = $835,208; plus 6% growth = $50,112; new balance = $885,320.

<u>SCENARIO 2, YEAR 4</u>

This year, Mary uses $80,000 (qualified) funds, increased $10,000 to maintain the household, pay taxes, and accommodate the increases reimbursable by the LTCI cycle, as explained below.

Mary estimates she will need 45 hours a week (6-7 hours per day) of care for John at $30 per hour. Mary spends $70,000 for John's care and is reimbursed from his LTCI benefit pool. This will allow her to do what she needs to do for herself and maintain the household.

Expenses Other Than Long-Term Care: $130,000 (includes inflation)

Household Income

SS	$37,506	(received a 2%, or $735, increase; 85% taxable = $31,880)
Pension	$25,000	
Qualified distribution	$80,000	(to meet cash needs to fund $32,862 federal tax for prior year plus $37,138 for household expenses and $10,000 to increase LTC reimbursement pool)
Rental income	<u>$10,000</u>	(after expenses)
Total income	$152,506	

Household Income Used for Long-Term Care Needs
Increased from $10,000 to $15,000, a non-interest-earning cycling asset total.

Federal Tax

AGI	$146,880	
Taxable income	$121,780	($146,880 income − $25,100 standard deduction)
Federal Tax	$26,792	($121,780 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
John and Mary use $80,000 (qualified) to support their household, pay income tax, and add to the LTC reimbursement benefit pool.

John and Mary's taxable income of $121,780 caused a tax of $26,792 ($121,780 x 22%). If John never needed LTC, John and Mary's income tax would be $24,592 (31,880 + $25,000 + $70,000 + $10,000 = $136,880; − $25,100 = $111,780; x 22%), or $2,200 less than what they actually paid.

Actual cost of care to the investment portfolio without renovations is $10,000.

- Distributions of $70,000 from retirement was normal and expected, not LTC related.
- Excluding $10,000 set aside for LTC reimbursement, the tax impact is $0 with no additional tax.
- There was no interest loss, other than interest on the $15,000, which is cycling asset.
- Cost of care for the LTC insurance is $70,000.

Total cost of care to the investment portfolio in the fourth year is **$0.**

Asset Comparison

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 4	$2,123,834	
Liquid assets going into year 5		
Qualified funds	$1,200,850*	
Roth	$27,270**	
Total		$1,228,120
Protected asset		
NQ funds		$917,239***
Total assets		$2,145,359 (excludes $15,000 cycling asset)

Net assets values

$21,525 gain from year 3 ($2,145,359 − $2,123,834)
$65,359 gain after 4 years ($2,145,359 − $2,080,000)

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052
2	$669,052	$50,000	$619,052
3	$619,052	$85,000	$534,052
4	$534,052	$70,000	$464,052
Total		**$235,000**	

Analysis

1. The tax impact due to John needing care was $2,200.
2. The cost of care reduced the portfolio due to the increase in the LTC reimbursement cycle asset. The portfolio continues to grow.
3. The interest lost is due to long-term reimbursement cycle asset, RMD, and normal, scheduled, additional qualified distributions, not direct LTC costs.
4. Cost of care in year 4 is $70,000, reimbursed by the LTCI company.
5. Overall cost of care to date from the investment portfolio is $15,000 plus interest loss from the LTC reimbursement cycle asset.
6. Investment Response:

A. *Q: $1,212,788 − $80,000 = $1,132,788; plus 6% growth of $67,967; new balance = $1,200,755.
B. **Roth: $25,726 − $0; + 6% = $1,544; = $27,270
C. ***NQ: $885,320 − $20,000 taxable interest (from NQ annuities in household income) = $865,320; plus 6% growth = $51,919; new balance = $917,239.

<u>SCENARIO 2, YEAR 5</u>

This scenario presents two options beyond caring for John at home: 5A – assisted living community (ALC) and 5B – skilled nursing facility (SNF).

John's memory is getting worse. He fails more frequently to recognize Mary, which is emotionally draining for Mary, and he's beginning to wander at night. Mary finds it difficult to sleep. Caring for him, even with the extra care on weekends, is difficult at home. Fearing for her own health, she has three options: (1) continue caring for him at home with added help and safeguarding John in the home, (2) placing him in a memory care unit within an assisted living community, or (3) placing him in a nursing home.

<u>5A – Assisted Living Community (ALC)</u>

In this scenario, John fit the criteria for the assisted living community, which presents an environment that is less medical and more of a normal style of living. Mary decides to place John in the assisted living community (ALC).

The additional cost above the $60,000 she spent last year for John's care is $48,000 a year, or $108,000 in total. John's long-term care insurance will support his entire expenses in an ALC up to its daily or monthly benefit. In this case, John's monthly benefit has grown to $19,419. This year Mary will submit a monthly bill ($9,000) to the insurance company for reimbursement. By building a relationship between the ALC and the LTC insurance company, Mary coordinates the bills to be submitted directly to the insurance company, and the ALC has agreed to have the insurance company directly reimburse them, alleviating Mary of the task.

John and Mary, in the process of planning and organizing, placed their non-qualified assets in a Medicaid trust in the event one or both would enter a skilled nursing facility/nursing home. Assets that are vulnerable are qualified funds above the community spouse allowance, $137,400 (2022). If John is admitted to a skilled nursing facility (SNF) and applied to Medicaid, these assets would be vulnerable. If John never enters an SNF, the effort to create a Medicaid trust would be worthless. Medicaid does not pay for assisted living communities; it is for private pay, those with LTC insurance, or people in programs such as PACE as discussed in Scenario 3.

The non-qualified annuity has been in the trust for years and is beyond the look-back period. The interest earned, back 5 years, is vulnerable once they exhaust the LTCI benefit. The plan is to keep John in the ALC until his policy is exhausted and then utilize what remains in John's retirement fund if needed. The only time John would need to go into an SNF is if he needs medical supported care that cannot be provided by the ALC.

Mary now sees the value of the advice she received when they were in their 50s and purchased their LTCI polices. Her only wish is that they had purchased larger benefits.
Based on the advice of her team of professionals, Mary uses the $15,000 (reimbursement cycle asset) she no longer needs, plus $65,000 (qualified) to maintain the household and pay taxes. Spending down their qualified assets is now a priority. Although Mary's team wants her to spend down their qualified assets, Mary and John have shared LTCI polices that allow Mary the ability to share her benefits with John, which gives her more time to protect her assets.

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256	(reflects a 2%, or $750, increase; 85% taxable = $32,518)
Pension	$25,000	
Qualified distributions	$65,000	(to meet cash needs to fund $26,792 federal tax for prior year plus $38,208 for household expenses)
Rental income	$10,000	(after expenses)
NQ annuity	$0	
Return to income	$15,000	(post tax, not taxable)
Total Income	$153,256	

Household Income Used for Long-Term Care Needs: $0

Federal Tax

AGI		$107,418	($132,518 income − $25,100 assumes itemized deductions other than medical equal standard deductions)
Taxable income	$107,418		
Federal tax	$23,632		($107,418 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
Normally, John and Mary use $80,000 (qualified funds) to support their household and pay income tax, creating a tax of $26,932 ($32,518 + $25,000 + $80,000 + $10,000 = $147,518; − $25,100 = $122,418 taxable income; x 22%), which is $3,300 ($26,932 − $23,632) less since John's care is supported by an LTC insurance and the agreement with the ALC, allowing the return of LTC imbursement asset.

John and Mary's taxable income of $107,418 caused a tax of $23,632. Actual cost of care to the investment portfolio without renovations is $0
.

- Distributions from retirement was normal and expected, not LTC related.
- LTC tax impact is $3,300 less, a positive impact.
- There was no interest loss due to distributions caused by the need for care.

Total cost of care to the investment portfolio in the fifth year is $0 with the return of $15,000 used for household expenses offsetting the qualified distribution.

Asset Comparison

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 5	$2,145,359	
Liquid assets going into year 6		
Qualified funds	$1,203,900*	
Roth	$28,906**	
Total		$1,232,806
Protected assets		
NQ funds		$972,273***
Total assets		$2,205,079

Net assets

$59,720 gain from year 4 ($2,205,079 − $2,145,359)
$125,079 gain after 5 years ($2,205,079 − $2,080,000)

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052
2	$669,052	$50,000	$619,052
3	$619,052	$85,000	$534,052
4	$534,052	$70,000	$464,052
5	$462,052	$108,000	$354,052
Total		**$343,000**	

Analysis

1. John's needing care created a positive tax impact due to needing less qualified distributions.
2. The portfolio continues to grow.
3. There was no interest lost due to long-term care costs; loss was due only to RMD and normal, scheduled, additional qualified distributions.
4. Cost of care in year 4 is $108,000, reimbursed by the LTCI company.
5. Overall cost of care to date from the investment portfolio is $0.
6. If John remains in an ALC, without inflation or added expenses, the LTCI will have accommodated his needs for 3.3 years.
7. Investment Response:
    A. *Q: $1,200,755 − $65,000 = $1,135,755; plus 6% growth of $68,145; new balance = $1,203,900.
    B. **Roth funds: $27,270 x 6% growth = $1,636; new balance = $28,906
    C. ***NQ: $917,239 − $0 = $917,239; plus 6% growth = $55,034; new balance = $972,273.

8. The portfolio has $2,205,079 after distributions, has increased by $125,079 over 5 years, and continues to grow, regardless of John's LTC issue.
9. The value of the home has increased $100,000 and will continue to appreciate.

Effects of ALC

Five Year Long-Term Care Investment Impact

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest	
1	$5,000	$300 x 5 yrs.	= $1,500	$90 x 5 yrs.	= $450
2	$0	$0 x 4 yrs.	= $0	$0 x 4 yrs.	= $0
3	$10,000	$600 x 3 yrs.	= $1,800	$108 x 3 yrs.	= $324
4	$0	$0 x 2 yrs.	= $0	$0 x 2 yrs.	= $0
5	−$15,000	−$900 x 1 yr.	= –$900	–$54 x 1 yr.	= –$54
Total	**$0**	**$0***	**$2,400**		**$720**

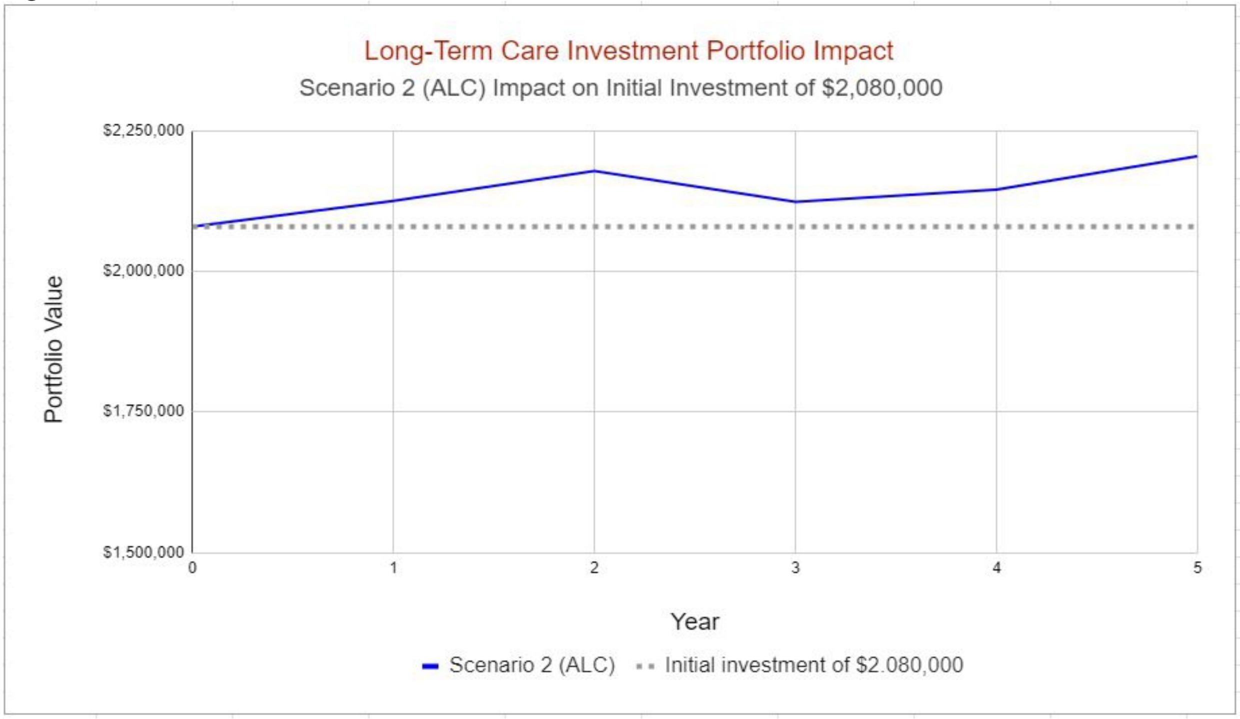
Interest impact over 5 years is $3,120 ($2,400 + 720)
*Interest represented in Scenario 2, years 1-5

Five Year Impact of Long-Term Care on Taxable Income and Tax

End of Year	Taxable Income without/with LTC	Tax without/with LTC	Tax Difference	Impact
1	$109,650/$109,650	$24,123/$24,123	$0	No Impact
2	$110,245/$110,245	$24,254/$24,254	$0	No Impact
3	$111,155/$136,155	$24,454/$29,954	+$5,500	Negative
4	$121,780/$152,506	$24,592/$26,792	+$2,200	Negative
5	$122,418/$107,418	$26,932 /$23,632	–$3,300	Positive
Total			+**$4,400**	Negative

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $7,520 ($0 + $2,400 + $720 + $4,400), or 0.36%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be .72%. If their portfolio was $500,000, the effect would be 1.5% of their liquid assets. Regardless of the negative impact, the portfolio continued to maintain growth beyond the initial value prior to John needing care.

Figure 16



Taxable income and income tax caused by the need for long-term care mirror each other, regardless of the home renovation and modification, creating a spike in year 3.

5B – Skilled Nursing Facility (SNF)

John's health has regressed, and Mary is emotionally disturbed, watching him decline. Concerned for her own emotional and physical health at age 85, she is forced to put him in a memory care unit within a skilled nursing (nursing home) facility (SNF). Cost of care is $16,000 a month, $192,000 a year. By building a relationship between the ALC and the LTC insurance company, Mary coordinates the bills to be submitted directly to the insurance company, and the ALC has agreed to have the insurance company directly reimburse them, alleviating Mary of the task. Mary no longer needs the $15,000 reimbursement cycle asset.

John and Mary, in the process of planning and organizing, placed their non-qualified assets in a Medicaid trust in the event one or both would enter a nursing home. Assets that are vulnerable are their qualified funds above the community spouse allowance, $137,400 (2022). The non-qualified annuity has been in the trust for years and is beyond the look-back period. The interest earned, back 5 years, is vulnerable once they exhaust the LTCI benefit. The plan is to exhaust the LTCI policy and then utilize what remains in John's retirement fund if needed or utilize Mary's option to share a portion of her LTC insurance policy.

Mary now sees the value of the advice she received when they were in their 50s and purchased their LTCI polices. Her only wish is that they had purchased larger benefits.

Based on the advice of her team of professionals, Mary uses $65,000 (qualified) to maintain the household and pay taxes. Spending down their qualified assets is now a priority. Although Mary's team wants her to spend down their qualified assets, Mary and John have shared LTCI polices that allow Mary the ability to share her benefits with John, which gives her more time to protect her assets.

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256	(reflects a 2%, or $750, increase; 85% taxable = $32,518)
Pension	$25,000	
Qualified distributions	$65,000	(to meet cash needs to fund $26,792 federal tax for prior year plus $38,208 for household expenses)
Rental income	$10,000	(after expenses)
Return to income	$15,000	(post tax, not taxable)
NQ annuity	$0	
Total income	$153,256	

Household Income Used for Long-Term Care Needs: $0

Federal Tax

AGI	$107,418	($32,518 + $25,000 + $65,000 + $10,000 = $132,518 income; − $25,100 assumes itemized deductions other than medical equal standard deductions)
Taxable income	$107,418	
Federal tax	$23,632	($107,418 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis

John and Mary would typically, without long-term care needs, use $80,000 (qualified funds) to support their household and pay income tax. John and Mary's taxable income of $107,418 ($32,518 + $25,000 + $80,000 + $10,000 = $147,518; − $25,100) causes a tax of $26,932 ($122,418 x 22%). This is $3,300 ($26,932 – $23,632) less income tax compared to when John was healthy. This is caused by the LTC insurance and the agreement with the SNF to bill the insurance company directly, allowing the return of SNF reimbursement asset.

The LTC insurance is paying for John's care. The tax with or without LTC is the same. There is no tax impact.

Actual cost of care to the investment portfolio without renovations is $0.

- Distributions from retirement was normal and expected, not LTC related.
- LTC tax impact is $0 with no additional tax.
- There was no interest loss due to LTC.

Total cost of care to the investment portfolio in the fifth year is **$0.**

Asset Comparison

Liquid assets going into year 1	$2,080,000	
Liquid assets going into year 5	$2,145,359	
Liquid assets going into year 6		
Qualified funds	$1,188,000*	
Roth	$28,906**	
Total		$1,216,906
Protected assets		
NQ funds		$972,273***
Total assets		$2,189,179

Net assets

$43,820 gain from year 4 (**$**2,189,179 − $2,145,359)

$109,179 gain after 5 years ($2,189,179 − $2,080,000)

Long-Term Care Insurance Value

Year	Benefit Pool	Reimbursement	Pool Balance
1	$699,052	$30,000	$669,052
2	$669,052	$50,000	$619,052
3	$619,052	$80,112	$538,940
4	$538,940	$70,000	$468,940
5	$468,940	$192,000	$276,940
Total		**$422,112**	

Analysis

1. The tax impact due to John needing care was nonexistent.
2. The cost of care did not reduce the portfolio as it did in Scenario 1. The portfolio continues to grow.
3. There was no interest lost due to long-term care costs; loss was due only to RMD and normal, scheduled, additional qualified distributions.
4. Cost of care in year 5 is $192,000, reimbursed by the LTCI company.
5. Overall cost of care to date from the investment portfolio is $0.
6. If John remains in a skilled facility, without inflation and added expenses, the LTCI will have accommodated his needs for 1.4 years, at which time Mary must decide whether to share her policy or begin to spend down John's retirement asset.
7. Investment response:
   A. *Q: $1,200,755 − $80,000 = $1,120,755; plus 6% growth of $67,245; new balance = $1,188,000.
   B. **Roth funds: $27,270 x 6% growth = $1,636; new balance = $28,906
   C. ***NQ: $917,239 − $0 = $917,239; plus 6% growth = $55,034; new balance = $972,273.
8. The portfolio has $2,189,179 after distributions, has increased by $109,179 over 5 years, and continues to grow, regardless of John's LTC issue.
9. The value of the home has increased $100,000 and will continue to appreciate.

Effects of SNF

Five Year Long-Term Care Investment Impact

End of Year	Direct Cost	5-Year Interest Impact	6% Compounding Interest
1	$5,000	$300 x 5 yrs. = $1,500	$90 x 5 yrs. = $450
2	$0	$0 x 4 yrs. = $0	$0 x 4 yrs. = $0
3	$10,000	$600 x 3 yrs. = $1,800	$108 x 3 yrs. = $324
4	$0	$0 x 2 yrs. = $0	$0 x 2 yrs. = $0
5	–$15,000	–$900 x 1 yr. = –$900	–$54 x 1 yr. = –$54
Total	**$0**	**$0*** **$2,400**	**$720**

Interest impact over 5 years is $3,120 ($2,400 + $720)
*Interest represented in Scenario 2, years 1-5

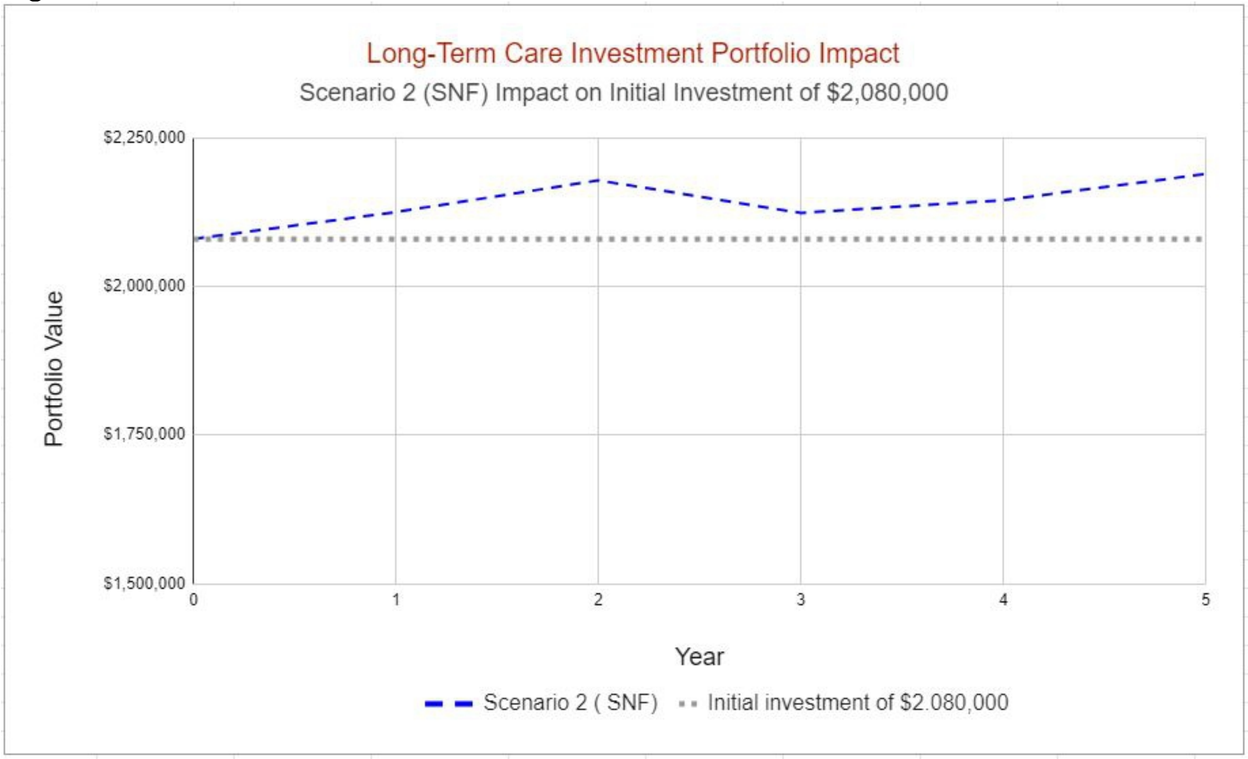
Five Year Impact of Long-Term Care on Taxable Income and Tax

End of Year	Taxable Income without/with LTC	Tax without/with LTC	Tax Difference	Impact
1	$109,650/$109,650	$24,123/$24,123	$0	No Impact
2	$110,245/$110,245	$24,254/$24,254	$0	No Impact
3	$111,155/$136,155	$24,454/$29,954	+$5,500	Negative
4	$121,780/$152,506	$24,592/$26,792	+$2,200	Negative
5	$122,418/$107,418	$26,932/$23,632	–$3,300	Positive
Total			+**$4,400**	Negative

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $7,520 ($0 + $2,400 + $720 + $4,400), or 0.36%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be .72%. If their portfolio was $500,000, the effect would be 1.5% of their liquid assets. Regardless of the negative impact, the portfolio continued to maintain growth beyond the initial value prior to John needing care.

The negative impact to the portfolio continued to affect the growth, putting the value below the initial value prior to John needing care.

Figure 17



Taxable income and income tax caused by the need for long-term care tax mirror each other, regardless of the home renovation and modification, creating a spike in year 3.

APPENDIX C

Scenario 3
Impact Analysis of Costs of Care, Taxes, and Assets

John has no long-term care insurance while Mary does. Confronting the need for long-term care, the couple approved their team of professionals to organize a plan under John and Mary's supervision. As in Scenario 2, the home and summer cottage are protected. In this scenario, public programs—elder services and Program for All-Inclusive Care for the Elderly[5] (PACE)—play a major role in John's care and their LTC asset protection strategy.

PACE is a state and federally funded program offered by the Department of Medicare and Medicaid Services. If you do not have Medicare or Medicaid, you can pay for PACE privately. The cost is usually capped. The state where the individual lives will determine the financial expectation and how these programs are implemented.

For John and Mary, PACE is available when they need care. PACE members must live within a specific catchment area of a PACE organization. Fortunately, John and Mary already were living in a PACE area when John had his stroke. PACE, coordinated with private/self-funded in-home care, will allow them to stay independent and safe. If they are in need of assisted living or skilled nursing, PACE works with appropriate establishments and creates an easy transition within the PACE network.

Knowing John was unable to purchase long-term care insurance, they isolated funds in special trusts in accordance with Community Medicaid regulations, directed specifically for John's care and shielding his assets.

With the guidance and advice from their team of fiduciaries, John and Mary strategically organized distributions (using Roth conversions and trusts) from their qualified funds over time to avoid large taxation, as recognized in Scenario 1, while meeting the criteria for government programs.

Because John's team has financially prepared John and Mary, when John is accepted into PACE, his medical needs are 100% covered, there's no need for supplemental health insurance, and there are no medical co-payments or deductibles. The monthly cost for John to receive PACE benefits is $1,500 greater than their household budgeted medical costs. However, in addition to the above, PACE provides 8 hours of home health care services or time at the adult day center Monday through Friday, a primary care physician, medical specialists, medications, and hospital stays. Many other health-related services such as dental care, transportation, and medical equipment are also covered.

Having John in PACE allows Mary to conduct household tasks while having time for herself. During the evenings and weekends, when John is not being cared for by PACE, Mary cares for him or has a private service spend time with him. PACE has taken the pressure off Mary and relieved her of much of the burden of caring for John.

Regardless of financial ability, PACE is available to everyone age 55 or older. You do not need to qualify for Medicaid. Private paying is acceptable. For tax purposes, the out-of-pocket cost for John to utilize PACE is included as a medical deduction.

For an overview of what PACE provides and costs, visit https://www.medicare.gov/your-medicare-costs/get-help-paying-costs/pace.

Since John is not eligible for LTCI, Mary has the burden of protecting the couple's assets. Mary's policy is an individual policy; therefore, the benefits are larger, taking into consideration the benefits in a couple's shared policies, offsetting the liability. Mary has the following LTCI benefits.

	Initial	30 years
Monthly benefit	$10,000	$24,272
Benefit value	$480,000	$1,165,085
25% cash (indemnity)	$2,000	$4,859

Compounding Inflation: 3%
90-day elimination period with 0-day for home health care (HHC)
Skilled nursing care professional
Annual premium: $9,406.18

Mary, wanting to be cared for at home, added skilled nursing care professional benefits to her policy.

Because John is unable to have LTCI, with the help of their team of professionals, John and Mary began converting their qualified assets into Roth and non-qualified accounts when he was 60, shifting the funds into Mary's name. When it becomes clear that John needs care, assuming age 80, John and Mary are comfortably positioned with their non-qualified accounts protected in trusts and Roth accounts as liquid assets.

The non-qualified accounts, in Mary's name, are protected from Medicaid accessibility in separate irrevocable trusts. They are outside the estate as an added protection in the event Mary needs care beyond her LTCI benefits. Having separate trusts offers flexibility if one needs to be accessed, breaking the irrevocable nature of that trust.

Although the non-qualified accounts earn taxable interest, they are protected. The Roth accounts earn tax-free interest, but they are vulnerable since they must remain tied to the person's Social Security number and cannot be a separate entity with its own tax identification number. Interest earned during the look-back period is vulnerable to Medicaid. Interest earned prior to the look-back period is protected.

Alternatively, if there were any non-qualified funds in John's name in a long-term care qualified annuity, the interest could be tax free if used for qualified long-term care expenses. The Pension

Protection Act of 2006 follows Section 7702B of the Health Insurance Portability & Accountability Act (HIPPA), which allows certain annuities, oftentimes medically underwritten, to provide a tax-free distribution (1099-LTC) for long-term care use.

John and Mary's income needs remain the same as in Scenarios 1 and 2. Their expenses are adjusted to accommodate the cost of John enrolled in PACE premium. The PACE premium is $1,500 greater than the above expenses and needs to be added into their monthly budget as John's LTC.

Tax and Legal Strategy

Since learning that John is unable to obtain LTCI, the couple scheduled qualified distributions (to include RMDs) more aggressively in coordination with the income tax strategy their team of professionals developed. Paying income tax and converting funds into a Roth account allow the funds to grow income tax–free before removing the funds from a qualified status to a non-qualified taxable interest program within a trust if needed. Moving funds from a Roth to a non-qualified Medicaid trust will protect assets above the need Mary may require if she exhausts her LTCI benefits. Two trusts are established and funded in advance—one when they began planning and a second trust when they are in their 70s, well before John needs care, fulfilling the current look-back period, as well as potential extensions. This will help protect the principal and interest earned prior to the look-back period.

Going into the period when John needs care, Mary is comfortable using this strategy and understands she has two funds to take money from, her qualified IRA and her Roth account.

Home Renovations

Accommodating John's future needs while enhancing their property value, John and Mary utilize some of the funds, preparing their home for future possibilities by adding a first-floor bedroom with a handicap accessible bathroom, as well as creating an easy entrance and egress. Since John and Mary are healthy and handy, they are able to make most of the improvements on their own, saving money. The addition and improvements have no impact on their investments. The cost of improvements takes place over time, not affecting their current income tax status while decreasing any capital gains when the property is eventually sold. Since their daughters live out of state, this also gives the couple added room when the families visit. If John and Mary never need care, they will have enhanced their property for future sale while enjoying the space in the interim.

Life-Changing Situation

At age 80, John suffers a stroke and is diagnosed with vascular dementia. As mentioned above, John and Mary have two children, married with their own families and living out of state, unable to help. Mary is going to need help caring for John and refuses to burden their children. After all, they have a strategy in place, and it's time to find out the level to which it will accommodate their needs.

John now needs care. Their assets are as follows.

Real Estate

- Primary residence valued at $1.2 million is in an irrevocable real estate trust.
- Summer cottage valued at $800,000 is in a separate entity, creating a $10,000 annual rental income.

Household Expenses

John and Mary's income compared to household expenses fluctuates +/- $3,000 from year to year throughout the study.

Liquid Assets

- Qualified funds of $200,000, combined (John $0 and Mary $200,000)
- Roth funds of $480,000 ($200,000 in John's name and $280,000 in Mary's name)
- The funds grow 6% annually.

Protected Assets (Separate Medicaid trusts—assets outside the estate)

- Longstanding non-qualified annuity of $800,000 in Mary's name; $200,000 is interest
- New non-qualified annuity, $600,000 in Mary's name
- The funds grow 6% annually.

Insurance (remains the same as in Scenarios 1 and 2)

- John and Mary each have a $250,000 permanent life insurance (total of $500,000) with a current cash value of $10,000 (total of $20,000) and an increasing death benefit option, current combined death benefit, $520,000. Although the cash value is an asset, it is not being considered in this study since it is enough to keep the policy going only to age 100.
- The policies do not offer accelerated death benefits options.
- Since John might be cared for in a skilled nursing home and may have to apply for Medicaid, the life insurance policy is placed in an irrevocable life insurance trust (ILIT), eliminating the cash value as a countable asset. Although the benefit will be taxable, it's better than allowing the value to be passed to the nursing home.

The following are the impacts to John and Mary for the five years after John's stroke.

SCENARIO 3, YEAR 1

In addition to using $70,000 (taxable qualified distribution) to maintain the household and pay income taxes, Mary spends $18,000 (PACE premium) from John's Roth fund within a pool of liquid assets for John's care, of which $18,000 is not taxable. They now have $18,000 in receipts that are added to their medical deductions and may help offset the tax consequences of the additional distributions.

Below, qualified distributions include RMDs. Qualified, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Assets

Liquid	
Qualified funds	$200,000
Roths	$480,000
Total	$680,000
Protected	
NQ: long-standing annuity	$800,000
NQ: new second annuity	$600,000
Total assets	$1,400,000

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$35,000	(85% taxable = $29,750)
Pension	$25,000	(level)
Qualified distribution	$70,000	(to meet cash needs to fund $24,123 federal tax for the prior year plus $45,877 for household expenses)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth distribution	$18,000	(PACE Premium)
Total income	$158,000	

Household Income Used for Long-Term Care Needs

Roth distributions	$18,000	
Total cost of care	$18,000	(qualifies as a medical deduction and is not taxable)

Federal Tax

AGI (adjusted gross income	$109,650	(Taxable income = $25,000 + $70,000 + $10,000 + taxable SS $29,750 = $134,750; AGI = $134,750 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$7,894	($134,750 x 7.5% = $10,106; $18,000 − $10,106 qualified medical expense deduction = $7,894)
Taxable income	$101,756	($109,650 − $7,894)
Federal tax	$22,386	($101,756 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis

Without the LTC costs and an additional $18,000 withdrawal, John and Mary's taxable income would be $134,750 and cause a tax of $24,123 ($134,750 − $25,100 = $109,650; x 22% = $24,123), which is $1,737 more ($24,123 − $22,386) than what they would pay with the LTC costs included, creating a positive impact. (Reference "Facts" on page 1 of study.)

Actual cost of care:

- LTC tax impact is $1,737 tax savings (difference between tax with and without medical deductions, $24,123 − $22,386), although it cost $18,000 of assets.
- Distributions for retirement = $18,000; interest loss on $18,000 at 6% = $1,080.
- Total cost of care in the first year is **$17,343** (distribution of $18,000 − tax savings of $1,737 + lost interest of $1,080).

Asset Comparison

Liquid assets going into year 1	$680,000		
Protected assets going into year 1	$1,400,000		
Assets going into year 2			
Liquid			
Qualified funds	$137,800*		
Roths	$489,720**		
Total		$627,520	
Protected			
NQ first (long-standing) annuity	$848,000†		
NQ second (new) annuity	$636,000††		
Total		$1,484,000	
Total assets			$2,111,520
Portfolio value at inception of John needing care			$2,080,000
Difference			$31,520 Gain

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, leaving the effective tax rate the same as the previous year.
2. Although the cost of care reduced the portfolio by $18,000, the portfolio gained $31,520.
3. The fund reduction cost the portfolio $1,080 in potential interest.
4. Cost of care in year 1 is **$17,343**.
5. Overall cost of care in year 1 and to date is **$17,343**.
6. Investment Response:
   A. *Q: $200,000 − $70,000 = $130,000; plus growth of 6% (= $130,000 x .06 = $7,800); new balance = $130,000 + $7,800 = $137,800.
   B. **Roth: $480,000 − $18,000 = $462,000; plus growth of 6% (= $27,720); new balance = $489,720.
   C. †NQ first annuity: $800,000 + growth of 6% (= $48,000) = $848,000.
   D. ††NQ second annuity (investment fund): $600,000 + 6% growth (= $36,000) = $636,000

SCENARIO 3, YEAR 2

Going into the second year, Mary is getting comfortable caring for John but wants more care beyond that provided by PACE. She finds it difficult to go places with John on the weekends, so she decides to hire help (respite care) for 6 hours on weekends. When the couple goes somewhere, this person joins them, and if John stays home, the person stays with him. With this in mind, she budgets an additional $10,000 a year. Plus, the PACE premium increased by $1,000 a year. Cost of care is approximately $29,000; however, respite care is not considered a medical deduction.

In addition to using $70,000 (taxable qualified distribution) to maintain the household and pay income tax, Mary spends $19,000 (PACE premium) and $10,000 from John's Roth account for John's care.

They now have $19,000 in receipts for medical deductions that will help offset the tax consequences of the additional distributions.

Below, qualified distributions include RMDs. Qualified, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Assets

Liquid	$619,840
Protected	$1,484,000

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$35,700	(85% taxable = $30,345)
Pension	$25,000	(level)
Qualified distribution	$70,000	(to meet cash needs to fund $22,386 federal tax for the prior year plus $47,614 for household expenses)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roths	$29,000	
Total Income	$169,700	

Household Income Used for Long-Term Care Needs

Roth distribution	$29,000	
Total cost of care	$29,000	$19,000 is taxable and qualifies as a medical deduction

Federal Tax

AGI	$110,245	(Taxable income = $25,000 + $70,000 + $10,000 + taxable SS $30,345 = $135,345; AGI = $135,345 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$8,849	($135,345 x 7.5% = $10,151; $19,000 − $10,151 qualified medical expense deduction = $8,849)

Taxable income	$101,396	($110,245 − $8,849)
Federal tax	$22,307	($101,396 x 22%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
Without the LTC costs and an additional $19,000 withdrawal, John and Mary's taxable income would have been $135,345 and caused a tax of $24,254 ($135,345 − $25,100 = $110,245 x 22% = $24,254), which is $1,947 more ($24,254 − $22,307) than what they paid with the LTC costs included, creating a positive impact.

Actual cost of care:

- LTC tax impact is savings of $1,947 (difference between tax with and without medical deductions ($24,254 − $22,307).
- Distributions from portfolio (Roth) = $29,000; interest loss on $29,000 at 6% = $1,740.
- Total cost of care in the second year is **$28,793** (distribution of $29,000 − tax savings of $1,947 + lost interest of $1,740).

Asset Comparison

Liquid assets going into year 3				
Qualified funds	$71,869*			
Roths	$488,363**			
Total		$560,232		
Protected assets going into year 3				
NQ first annuity	$898,880†			
NQ second annuity	$674,160††			
Total		$1,573,040		
Total assets			$2,133,272	
Portfolio value at inception of John needing care			$2,080,000	
Difference			**$53,272**	Gain over 2 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, leaving the effective tax rate the same as the previous years.
2. Although the cost of care reduced the portfolio by $29,000, the portfolio has gained a cumulative $53,272 since inception.
3. The fund reduction cost the portfolio $1,740 in potential interest.
4. Cost of care in year 2 is **$28,793**.
5. Overall cost of care in years 1 and 2 is **$46,136**.
6. Investment Response:
   A. *Q: $137,800 − $70,000 = $67,800; plus growth of 6% (= $67,800 x .06 = $4,069); new balance = $67,800 + $4,069 = $71,869.
   B. **Roth: $489,720 – $29,000 = $460,720; plus growth of 6% (= $27,643); new balance = $488,363.
   C. †NQ first annuity: $848,000 + growth of 6% (= $50,880); new balance = $898,880.
   D. ††NQ second annuity: $636,000 + 6% growth (= $38,160) = $674,160.

SCENARIO 3, YEAR 3

Going into the third year, Mary is comfortable with the way John is being cared for. She continues to hire help (respite care) for 6 hours on weekends. Her respite care budget remains at $10,000 a year; plus the PACE premium increased by $1,000 a year again, from $19,000 to $20,000. Cost of care is approximately $30,000; however, respite care is not considered a medical deduction.

In addition to using $70,000 ($35,000 as a taxable qualified distribution and $35,000 as a Roth distribution from John's account) to maintain the household and to pay income tax, Mary spends $20,000 (PACE premium) and $10,000 from John's Roth account for John's care.

They now have $20,000 in receipts for medical deductions that will help offset the tax consequences of the additional distributions.

Below, qualified distributions include RMDs. Qualified, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Asset Values Going into Year 3

Liquid	$561,610
Protected	$1,573,040

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$36,771	(85% taxable = $31,255)
Pension	$25,000	(level)
Qualified distribution	$35,000	(to meet cash needs to fund $22,307 federal tax for the prior year plus $12,693 for household expenses)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth	<u>$65,000</u>	($30,000 LTC and $35,000 for household use)
Total Income	$171,771	

This year, $35,000 was distributed from taxable qualified funds and the Roth accounts for household use.

Household Income Used for Long-Term Care Needs

Roth distribution	$30,000	
Total cost of care	$30,000	$20,000 is taxable and qualifies as a medical deduction.

Federal Tax

AGI	$76,155	(Taxable income = $25,000 + $35,000 + $10,000 + taxable SS $31,255 = $101,250; AGI = $101,255 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)

Medical deduction	$12,406	($101,255 x 7.5% = $7,594; $20,000 − $7,594 qualified medical expense deduction = $12,406)
Taxable income	$63,749	($76,155 − $12,406, changes tax rate to 12%)
Federal tax	$7,650	($63,744 x 12%, effective rate paid out of qualified funds)

Tax/Investment Impact Analysis
Without the LTC costs and an additional $20,000 withdrawal, John and Mary's taxable income would have been $135,345 and caused a tax of $24,454 ($31,255 + $25,000 + 70,000 + $10,000 = $136,255; − $25,100 = $111,155; x 22% = $24,454), which is $16,804 more ($24,454 − $7,650) than what they paid with the LTC costs included, creating a positive tax impact. If there were no long-term care needs, $70,000 would have been taken as a qualified distribution, rather than splitting it between qualified and Roth accounts.

However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $16,804 ($24,454 − $7,650).

Actual cost of care:

- LTC tax impact is savings of $16,804 (difference between income tax with and without medical deductions: $7,650 − $24,454).
- Distributions from portfolio (Roth) = $65,000; interest loss on $30,000 at 6% = $1,800.
- Total cost of care in year 3 is **$14,995** (distribution of $30,000 − tax savings of $16,805 + lost interest of $1,800).

Asset Comparison

Liquid assets going into year 4			
Qualified funds	$39,081*		
Roths	$448,765**		
Total		$487,846	
Protected assets going into year 4			
NQ first annuity	$952,813†		
NQ second annuity	$714,610††		
Total		$1,667,423	
Total assets			$2,155,269
Portfolio value at inception of John needing care			$2,080,000
Difference			**$75,269** gain over 3 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 22% to 12%.
2. The cost of care reduced the portfolio by $30,000; however, the portfolio value has experienced a cumulative growth of $75,269 since inception ($2,155,269 − $2,080,000).
3. The fund's reduction cost the portfolio $1,740 in potential interest.
4. Cost of care in year 3 is **$14,995**.

5. Overall cost of care to date is **$61,131**.
6. Investment Response:
   A. *Q: $71,869 − $35,000 = $36,869; plus, growth of 6% (= $38,267 x .06) = $2,212; new balance = $36,869 + $2,212 = $39,081.
   B. **Roth: $488,363 – $65,000 = $423,363; plus, growth of 6% (= $25,402); new balance = $448,765.
   C. †NQ first annuity: $898,880 + growth of 6% (= $53,933); new balance = $952,813.
   D. ††NQ second annuity: $674,160 + 6% growth (= $40,450) = $714,610.

SCENARIO 3, YEAR 4

Although John is getting more difficult to care for, going into the fourth year, Mary remains comfortable with the way things are going. She continues to hire help (respite care) for 6 hours on weekends. Her respite care budget remains at $10,000 a year; plus, the PACE premium increased $1,000 a year, from $20,000 to $21,000. Cost of care is approximately $31,000; however, respite care is not considered a medical deduction.

Since the couple's income tax dropped $14,658 (year 2, $22,307 – year 3, $7,649), Mary took $60,000 ($39,081 is a taxable qualified distribution and $20,919 is a Roth distribution) to maintain the household and pay income tax. Mary spends an additional $21,000 (PACE premium) and $10,000 from John's Roth account for John's care.

Their taxable qualified funds are now depleted, and they have $21,000 in receipts for medical deductions that will help offset the tax consequences of the additional distributions.

Below, qualified distributions include RMDs. Qualified, non-qualified (NQ), and Roth responses reflect the increase and decrease of financial growth due to interest and LTC expenses.

Assets Going into Year 4

Liquid	$487,825
Protected	$1,667,423

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$37,506	(85% taxable = $31,880)
Pension	$25,000	(level)
Qualified distribution	$39,081	(to meet cash needs to fund $7,650 federal tax for the prior year plus $31,431 for household expenses)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth	$51,919	($31,000 LTC and $20,919 for household use)
Total Income	$163,506	

This year, $39,081 was distributed from qualified funds, exhausting the fund, while $20,919 was distributed from John's Roth accounts for household use.

Household Income Used for Long-Term Care Needs

Taxable distribution	$21,000	
Roth distribution	<u>$10,000</u>	
Total cost of care	$31,000	$21,000 is taxable and $31,000 qualifies as a medical deduction

Federal Tax

AGI	$72,861	(Taxable income = $25,000 + $31,081 + $10,000 + taxable SS $31,880 = $97,961; AGI = $97,961 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$13,653	($97,961 x 7.5% = $7,347; $21,000 − $7,347 qualified medical expense deduction = $13,653)
Taxable income	$59,208	($72,861 − $13,653, changes tax rate to 12%)
Federal tax	$7,105	($59,208 x 12%, effective rate paid out of taxable funds)

Tax/Investment Impact Analysis

Without the LTC costs and an additional $21,000 withdrawal, John and Mary's taxable income would have been $135,345 and caused a tax of $24,592 ($31,880 + $25,000 + $70,000 + $10,000 = $136,880 − $25,100 = $111,780; x 22% = $24,592), which is $17,487 more ($24,592 − $7,105) than what they paid with the LTC cost included, creating a positive impact. If there were no long-term care needs, the tax consequences would have been different; $70,000 would have been taken as a qualified distribution, rather than $60,000 split between qualified and Roth accounts.

However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $17,487 ($24,592 − $7,105).

Actual cost of care:

- LTC tax impact is savings of $17,487 (difference between income tax in year 4 with and without medical deductions ($24,592 − $7,105).
- Distributions from portfolio (qualified and Roth); interest loss on $31,000 at 6% = $1,860.
- Total cost of care in year 4 is **$15,373** (distribution of $31,000 − tax savings of $17,487 + lost interest of $1,860).

Asset Comparison

Liquid assets going into year 5			
Qualified funds	$0*		
Roths	$420,657**		
Total		$420,657	
Protected assets going into year 5			
NQ first annuity	$1,009,982†		
NQ second annuity	$757,487††		
Total		$1,767,469	
Total assets			$2,188,126
Portfolio value at inception of John needing care			$2,080,000
Difference			**$108,126** gain over 4 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 22% to 12%.
2. The cost of care reduced the portfolio by $31,000; however, the portfolio value has experienced a cumulative growth of $108,126 since inception ($2,188,126 − $2,080,000).
3. The fund's reduction cost the portfolio $1,860 in potential interest ($31,000 x 6%).
4. Cost of care in year 4 is **$15,373**.
5. Overall cost of care to date is **$76,504**
6. Investment Response:
   A. *Q: $39,081 − $39,081 = $0. Taxable qualified fund is depleted.
   B. **Roth: $448,765 – $51,919 = $396,846; plus, growth of 6%, $23,811; new balance = $420,657.
   C. †NQ first annuity: $952,813 + growth of 6% (= $57,169); new balance = $1,009,982.
   D. ††NQ second annuity: $714,610 + 6% growth (= $42,877) = $757,487.

<u>SCENARIO 3, YEAR 5</u>

This scenario presents two options beyond caring for John at home, 5A – assisted living community (ALC) and 5B – skilled nursing facility (SNF).

John's memory is getting worse. He fails to recognize Mary more frequently, which is emotionally draining for Mary, and he's beginning to wander at night. Caring for him, even with the extra care on weekends, is difficult at home. Mary finds it difficult to sleep and is concerned that her own wellbeing is being threatened.

She has three options: continue caring for him at home with added help and safeguarding John in the home, placing him in a memory care unit within an assisted living community, or placing him in a nursing home. Mary meets with her team at PACE to discuss her options. She visits the assisted living communities and nursing homes that are affiliated with PACE. By placing John in a PACE affiliated assisted living or nursing home, John will maintain the same doctors he had at home.

Financially, going into the fifth year, John's Roth account has diminished to $67,163. Mary's Roth account has $353,494 remaining. Her traditional IRA has been exhausted.

John's Roth account

Year	Value	Distribution	6% Interest	Balance
1	$200,000	− $18,000	+ 10,920	$192,920
2	$192,920	− $29,000	+ $9,835	$173,755
3	$173,755	− $65,000	+ $6,525	$115,280
4	$115,280	− $51,919	+ $3,802	$67,163

5A – Assisted Living Community

John fit the criteria for the assisted living community, which presents an environment that is less medical and more of a normal style of living, which he is accustomed to. Mary decides to place John in the assisted living community (ALC).

The additional premium above the $21,000 (PACE premium) she spent last year is $2,200 a month, totaling $47,400 a year, of which $27,400 is considered a medical deduction. Rent, food, and other accommodations are not medical deductions. She will no longer need respite care on weekends.

Along with the cost of care, Mary will need $60,000 from her pool of assets to pay for household expenses and income tax as in previous years. Since her tax rate has dropped, she takes $60,000, not $70,000.

Liquid Assets Going into Year 5

Liquid (Roth)	$420,635
Protected	$1,767,469

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256	(85% taxable = $32,518)
Pension	$25,000	(level)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth	$107,400	($47,400 LTC and $60,000 for household use and federal income tax)
Total income	$180,656	

This year, $107,400 was distributed from the Roth accounts for taxes, household use, and LTC. John's Roth account is now exhausted. The remaining Roth value is in Mary's name.

Household Income Used for Long-Term Care Needs

Roth distribution	$47,400	
Total cost of care	$47,400	$47,400 qualifies as a medical deduction.

Federal Tax

AGI	$42,418	(Taxable income = $25,000 + $10,000 + taxable SS $32,518 = $67,518; AGI = $67,518 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$22,336	($67,518 x 7.5% = $5,064; $27,400 − $5,064 qualified medical expense deduction = $22,336)
Taxable income	$20,082	($42,418 − $22,336, changes tax rate to 10%)
Federal tax	$2,008	($20,082 x 10%, effective rate paid out of taxable funds)

Tax/Investment Impact Analysis: ALC

Without the LTC costs and an additional $47,000 withdrawal, John and Mary's taxable income would have been $137,518 and caused a tax of $24,732 ($32,518 + $25,000 + $70,000 + $10,000 − $25,100 = $112,418; x 22% = $24,732), which is $22,724 more ($24,732 − $2,008) than what they paid with the LTC cost included, creating a positive impact. If there were no long-term care needs, $70,000 would have been taken as a qualified distribution, rather than using the Roth accounts.

However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $22,724 ($24,732 − $2,008).

Actual cost of care:

- LTC tax impact is savings of $22,724 (difference between income tax in year 5 with and without medical deductions ($24,732 − $2,008).
- Distributions from portfolio (Roth) = $47,400; interest loss on $47,400 at 6% = $2,844.
- Total cost of care in year 5 is **$27,520** (distribution of $47,400 − tax savings of $22,724 + lost interest of $2,844).

Asset Comparison

Liquid assets going into year 6				
Qualified funds	$0*			
Roth	$332,052**			
Total		$332,052		
Protected assets going into year 6				
NQ first annuity	$1,070,581†			
NQ second annuity	$802,936††			
Total		$1,873,517		
Total assets			$2,205,569	
Portfolio value at inception of John needing care			$2,080,000	
Difference			**$125,569**	gain over 5 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 12% in years 3 and 4 to 10% in the fifth year.
2. The cost of care reduced the portfolio by $47,400; however, the portfolio value has experienced a cumulative growth of $125,569 since inception ($2,205,569 − $2,080,000).
3. The fund reduction cost the portfolio $2,844 in potential interest.
4. Cost of care in year 5 is **$27,520**.
5. Overall cost of care to date is **$104,024**.
6. Investment Response:
   A. *Q: $0.
   B. **Roth: $420,657 – $107,400 = $313,257; plus, growth of 6% (= $18,795); new balance = $332,052.
   C. †NQ first annuity: $1,009,982 + growth of 6% (= $60,599) = $1,070,581.
   D. ††NQ second annuity: $757,487 + 6% growth (= $45,449) = $802,936.

Effects of ALC

Five Year Long-Term Care Investment Impact

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$18,000	$1,080 x 5 yrs. =	$5,400	$324 x 5 yrs. = $1,620
2	$29,000	$1,740 x 4 yrs. =	$6.960	$418 x 4 yrs. = $1,672
3	$30,000	$1,800 x 3 yrs. =	$5,400	$324 x 3 yrs. = $972
4	$31,000	$1,860 x 2 yrs. =	$3,720	$223 x 2 yrs. = $446
5	$47,400	$2,844 x 1 yr. =	$2,844	$171 x 1 yr. = $171
Total	**$155,400**	$9,324*	**$24,324**	**$4,881**

*Interest represented in Scenario 3, years 1-5

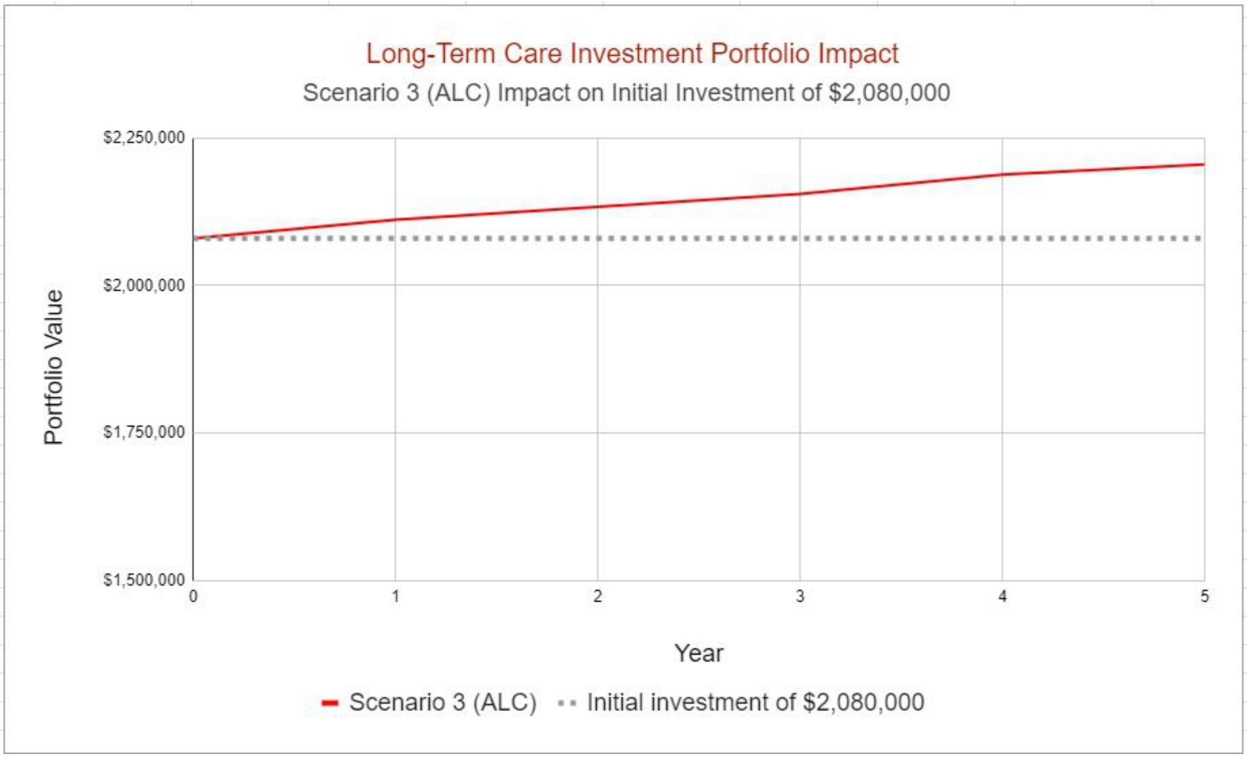
Five Year Impact of Long-Term Care on Taxable Income and Tax

End of Year	Taxable Income without/with LTC	Tax without/with LTC	Tax Difference*	Impact
1	$134,750/$101,756	$24,123/$22,386	−$1,737	Positive
2	$135,345/$101,396	$24,254/$22,307	−$1,947	Positive
3	$135,345/$63,744	$24,454/$7,649	−$16,805	Positive
4	$135,345/$59,208	$24,592/$7,105	−$17,487	Positive
5	$137,518/$20,082	$24,732/$2,008	−$22,724	Positive
Total			**−$60,700**	Positive

*Difference between the income tax without the need for LTC compared to the income tax with LTC costs and medical deductions.

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $123,905 ($155,400 + $24,324 + $4,881 − $60,700), or 5.96%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be 11.91%. If their portfolio was $500,000, they would have spent 24.78% of their liquid assets. Regardless of the negative impact, the portfolio continued to maintain growth beyond the initial value prior to John needing care.

Figure 18



Taxable income and the long-term care tax impact remained consistent and stable.

<u>Year 5B − Skilled Nursing Facility (SNF)</u>

John's illness has gotten to the point where he does not fit the criteria for the assisted living community and is placed in a skilled nursing facility (SNF).

Going into the fifth year, Mary has $420,657 remaining in the Roth accounts, of which $67,163 is in John's name. Before Medicaid will help pay the nursing home bill, Mary has three options to consider. Regardless of the option, Mary must conform to the Medicaid rules in her state (in this example, Massachusetts) unless she decides to private pay for John's care. When applying for Medicaid assistance, the private pay rate is different from the state Medicaid negotiated reimbursement rate to the nursing home. In this example, the SNF private pay is $192,000 annually, while the Medicaid rate is $96,000. Based on the Medicaid calculation, $2,000 is allotted to John, the institutionalized spouse, and $137,400 is the Community Spouse Resource Allowance (CSRA), which goes to Mary, leaving $281,235 to be spent down before Medicaid will provide assistance. Regardless of the three options below, John's Social Security benefit and pension will be redirected to the SNF. Mary has the following three options to manage her financial situation.

1. Spend down, otherwise private pay, her liquid assets ($281,257) to the allowable limits, $2,000 and $137,400, and then Medicaid will pay assist with John's care.
2. Create a Medicaid restricted (compliant) income stream using funds from the Roth account based on John's age and the actuarial table information using $281,257 liquid assets.
   Note: "Name on the Check Rule" means the income belongs to the person whose name is on the check. This rule in reference to Medicaid ruling 42 U.S. 1396r-5 means the check of the payout of a restricted annuity can be made payable to the community spouse and is not recognized as a countable asset to Medicaid. The implementation of this rule would create a similar investment structure as demonstrated in option 3 below.
3. Since Mary's Roth account ($214,072) is in Mary's name, an income stream can be created directing the funds away from John and into an irrevocable trust. The remaining balance in John's Roth ($67,163 − $2,000) can be directed to Mary using the Name on the Check Rule as presented in option 2.

<u>5B, Option 1</u>

The cost to live in the SNF is $192,000 a year. Mary will spend down and private pay the first year and then apply for Medicaid assistance beginning in the second year John resides in the SNF.

Mary will need $60,000 from her pool of assets to pay for household expenses and income tax as in previous years, plus $192,000 for John's care in the SNF. She distributes $252,000 from their Roth accounts, exhausting John's.

Assets Going into Year 5

Liquid	$420,635
Protected	$1,767,469

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256	(85% taxable = $32,518)
Pension	$25,000	(level)
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth	<u>$252,000</u>	($192,000 LTC and $60,000 for household use and federal income tax)
Total Income	$325,256	

This year, $252,000 was distributed from the Roth accounts for taxes, household use, and LTC.

Household Income Used for Long-Term Care Needs

Roth distribution	$192,000	
Total cost of care	$192,000	100% is not taxable and qualifies as a medical deduction

Federal Tax

AGI	$42,418	(Taxable income = $25,000 + $10,000 + taxable SS $32,518 = $67,518; AGI = $67,518 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$186,936	($67,518 x 7.5% = $5,064; $192,000 − $5,064 qualified medical expense deduction = $186,936)
Taxable income	($144,518)	($42,418 − $186,936, changes tax rate to 0%)
Federal tax	$0	($186,936 x 0%, effective rate paid out of taxable funds)

John and Mary's tax liability is $0.

Tax/Investment Impact Analysis, Option 1

Without the LTC costs and an additional $192,000 withdrawal, John and Mary's taxable income would have been $137,518 and caused a tax of $24,732 ($32,518 + $25,000 + $70,000 + 10,000 = $137,518; − $25,100 = $112,418; x 22% = $24,732). If there were no long-term care needs, $70,000 would have been taken as a qualified distribution, rather than using the Roth accounts. However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $24,732 since there is $0 income tax ($24,732 + negative $144,518 = $0 tax liability), causing a $24,732 positive tax impact.

Actual cost of care:

- LTC tax impact is savings of $24,732 (difference between income tax in year 5 with and without medical deductions ($0 − $24,732).
- Distributions from portfolio (Roth) = $192,000; interest loss on $192,000 at 6% = $11,520.
- Total cost of care in year 5 is **$178,788** (distribution of $192,000 − tax savings of $24,732 + lost interest of $11,520).

Asset Comparison

Liquid assets going into year 6			
Qualified funds	$0*		
Roth	$178,776**		
Total		$178,776	
Protected assets going into year 6			
NQ first annuity	$1,070,581†		
NQ second annuity	$802,936††		
Total		$1,873,517	
Total assets			$2,052,293
Portfolio value at inception of John needing care			$2,080,000
Difference			**$27,707** reduced over 5 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 22% to 12% to 10% and now to 0%.
2. The cost of care reduced the portfolio by $192,000, reducing the initial portfolio value $27,707 since inception ($2,080,000 − $2,052,293).
3. The fund reduction cost the portfolio $11,520 in potential interest.
4. Cost of care in year 5 is **$178,788**.
5. Overall cost of care to date is **$255,292**.
6. Investment Response:
    A. *Q: $0.
    B. **Roth: $420,657 – $252,000 ($60,000 + $192,000) = $168,657; plus, growth of 6% ($10,119) = $178,776.
    C. †NQ first annuity: $1,009,982 + growth of 6% = $60,599; new balance = $1,070,581.
    D. ††NQ second annuity: $757,487 + 6% growth (= $45,449) = $802,936.

5B, Option 2

Mary decided to create an additional income stream using a Medicaid compliant (restricted) annuity and implementing the Name on the Check Rule. Going into the fifth year, John has $67,163 in his Roth account, while Mary has $353,494 in her Roth account, making $420,657 combined. Using this method, based on the remaining assets after Mary assigns John $2,000 as the institutionalized person's allowance and retains $137,400 as her CSRA, she places the remaining $281,257 into a restricted/compliant annuity. At John's age of 85 and given the number of years the actuarial table dictates, the annuity will pay out $46,873 each year for 6 years. This should make him Medicaid eligible, which will allow assets to be distributed to the beneficiary or beneficiaries in the event John dies before the sixth year of the annuity. While John is alive, the income will be paid out in Mary's name using the Name on the Check Rule. She will use the money for living expenses, and the excess will be funneled into an irrevocable trust. Since John's Social Security benefit and pension will be assigned to the SNF, the income from the annuity will help offset the loss of his household income contribution.

Below is the tax and investment impact using this strategy.

Assets Going into Year 5

Liquid	
Roth, Community Spouse Resource Allowance (CSRA)	$137,400
Institutionalized person allowance	$2,000
Medicaid compliant annuity*	$281,257 ($420,657 − $2,000 − $137,400)
Protected	$1,767,469
Total assets	$2,188,126

*When funds are placed in a restricted income annuity, they are no longer considered an asset. However, for the purpose of this study, tracking the reduction of the annuity and recording it as an asset is necessary.

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256	(85% taxable = $32,518)
Pension	$25,000	
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth restricted annuity	$46,873	(household $60,000 + $25,149 + $25,000 = $110,149)
Roth	$63,276	(additional household use and federal income tax)
Total income	$186,405	

This year, $110,149 was distributed from the Roth accounts from separate accounts, one from John's restricted annuity and the other from Mary's traditional Roth.

Household Income Used for Long-Term Care Needs

Since John and Mary's assets are protected in trusts and they have the use of a restricted Medicaid annuity, the Medicaid assumed rate for a nursing home is $8,000 a month, or $96,000 annually.

John will still assign his Social Security and pension to the nursing home. The restricted annuity income was directed to Mary in her name.

Household Income Used

John's Social Security benefit	$25,149
John's pension	$25,000
Total Income	$50,149
Total cost of care	$96,000

The cost of care is $45,851 greater than what John paid the nursing home, which is the amount Medicaid will pay the facility for John's care.

With the assignment of John's Social Security benefit and pension to the nursing home, without requesting a CSRA income, Mary will need to distribute $63,276 from her CSRA to compensate for the difference in order to pay her household expenses and income tax.

John's cost of care reduced the portfolio by $50,149 since his Social Security and pension needed to be replaced.

Although John's Social Security benefit has been assigned to the SNF, it is still taxable as ordinary income. John's Social Security and pension are applied toward their medical deduction on the income taxes.

Federal Tax

AGI	$42,418	(Taxable income = $25,000 + $10,000 + taxable SS $32,518 = $67,518; AGI = $67,518 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$45,085	($67,518 x 7.5% = $5,064 − $50,149)
Taxable income	($2,667)	($45,085 − $42,418)
Federal tax	$0	(negative $2,418 = $0)

John and Mary's income tax is $0.

The Name on the Check Rule created an income offsetting John's Social Security benefit and pension.

Income tax using the Roth account method is $0, while income tax on the Name on the Check Rule concept is also $0 since both incomes are from a Roth IRA.

<u>Tax/Investment Impact Analysis, Option 2</u>

Initially, without the LTC costs and an additional withdrawal, John and Mary's taxable income would have been $137,518 and caused a tax of $24,732 ($32,518 + $25,000 + $70,000 + 10,000 = $137,518; − $25,100 = $112,418; x 22% = $24,732). If there were no long-term care needs, $70,000 would have been taken as a qualified distribution, rather than using the Roth accounts for LTC. However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $24,732 since there is $0 income tax ($24,732 + $0 tax liability), causing a $24,732 positive tax impact.

Actual cost of care:

- LTC tax impact is savings of $24,732 (difference between income tax in year 5 with and without medical deductions ($0 − $24,732).
- Distributions from the portfolio (Roth) = $46,873; interest loss on $46,873 at 6% = $2,812.
- Assignment of John's Social Security and pension = $50,149
- Total cost of care in year 5 is **$28,229** (SS and pension of $50,149 − tax savings of $24,732 + lost interest of $2,812).

Asset Comparison

Liquid assets going into year 6

Qualified funds	$0*	
Roth	<u>$329,139</u>**	
Total		$329,139

Protected assets going into year 6			
NQ first annuity	$1,070,581†		
NQ second annuity	$802,936††		
Total		$1,873,517	
Total assets			$2,202,656
Portfolio value at inception of John needing care			$2,080,000
Difference			**$122,656** greater over 5 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 22% to 12% to 10% and now to 0%.
2. The cost of care reduced the portfolio by $50,149, while the initial portfolio value grew $122,656 since inception ($2,202,656 − $2,080,000).
3. The fund reduction cost the portfolio $2,812 in potential interest.
4. Cost of care in year 5 is **$28,229**.
5. Overall cost of care to date is **$132,253**.
6. Investment Response:
    A. *Q: $0.
    B. **Roth: $420,657 – $46,873 (restricted) − $63,276 (CSRA) = $310,508 + 6% growth ($18,631) = $329,139
    C. †NQ first annuity: $1,009,982 + growth of 6% = $60,599; new balance = $1,070,581.
    D. ††NQ second annuity: $757,487 + 6% growth (= $45,449) = $802,936.

5B, Option 3

Since John and Mary planned years before John needed care, they were able to strategically convert a sizable portion of their traditional IRAs into Roth IRA accounts by paying the tax over a 25-year period. Going into year 5, John's Roth has $67,163 while Mary's Roth has $353.494.

First, Mary will assign $2,000 from John's Roth to the facility as an institutionalized allowance for John.

Second, she will place the remaining $65,163 into a restricted/compliant annuity, spreading the income over 6 years and using the Name on the Check Rule as discussed in 5B, option 2. This will provide Mary with $10,861 a year to apply to her household expenses.

Third, Mary can place $216,094 (funds remaining after $137,400 CSRA) into a Roth income annuity that will pay her $22,241 annually for 10 years, which will help offset John's Social Security benefit ($25,149) and pension ($25,000) that have been assigned to the SNF. Income that Mary receives above what is needed for her household use can be placed in an irrevocable trust account, removing the income from Mary's estate, therefore not considered a countable asset to Medicaid.

Below is the tax and investment impact using this strategy.

Assets Going into Year 5

Roth, initially valued at $420,657.

Liquid assets, after repositioning the assets as discussed above:

Community spouse resource allowance (CSRA)	$137,400	
Institutionalized person's allowance	$2,000	
Mary's income annuity value	$216,094 ($0)*	
John's restricted annuity	$65,163 ($0)*	
Total liquid assets		$420,657
Protected assets		$1,767,469
Total assets		$2,188,126

*When funds are placed in the type of income annuity mentioned above, the asset is assigned to the insurance company with a promise to pay it back as income over a predetermined period. In this example, the asset no longer belongs to the individual; it belongs to the insurance company. Therefore, it has a $0 asset value to Mary and is not a countable asset to Medicaid. For this study, the income note distributed is being recorded as an asset.

Expenses Other Than Long-Term Care: $130,000

Household Income

SS	$38,256*	(85% taxable = $32,518)
Pension	$25,000*	
Rental income	$10,000	(after expenses, may be paid to Mary only)
Roth CSRA	$74,067	(for household use and $7,105 federal income tax)
Roth income annuity	$22,242	
Roth (restricted)	$10,861	
Total income	$180,426	

*Although John's Social Security benefit has been assigned to the SNF, it is still taxable as ordinary income.

This year, $107,170 was distributed from the Roth accounts (CSRA, Mary's income annuity, and John's restricted annuity) to pay taxes and household use.

Federal Tax

AGI	$42,418	(Taxable income = $25,000 + $10,000 + taxable SS $32,518 = $67,518; AGI = $67,518 − $25,100 standard deduction; assume itemized deductions other than medical equals standard deduction)
Medical deduction	$45,085	($67,518 x 7.5% = $5,064; $50,149 [SS $25,149 + pension $25,000] − $5,064 qualified medical expense deduction = $45,085)
Taxable income	($2,667)	($42,418 − $45,085, changes tax rate to 0%)
Federal tax	$0	($45,085 x 0%, effective rate paid out of taxable funds)

John and Mary's tax liability is $0.

Tax/Investment Impact Analysis, Option 3

Initially, without the LTC costs and additional withdrawal, John and Mary's taxable income would have been $137,518 and caused a tax of $24,732 ($32,518 + $25,000 + $70,000 + 10,000 = $137,518; − $25,100 = $112,418; x 22% = $24,732). If there were no long-term care needs, $70,000 would have been taken as a qualified distribution, rather than using the Roth accounts. However, cost of care is relevant. The impact of the actual cost of care is an income tax savings of $24,732 since there is $0 income tax ($24,732 + negative $91,958 = $0 tax liability), causing a $24,732 positive tax impact.

Actual cost of care:

- LTC tax impact is savings of $24,732 (difference between income tax in year 5 with and without medical deductions ($0 − $24,732).
- Distributions from the portfolio (Roth) related to John's care is $33,103 ($22,242 + $10,861); interest loss on $216,094 at 5% (since Mary's annuity earns 1%) = $10,805, plus 6% on $137,400 (CSRA) = $8,244; combined interest loss is $19,049.
- Assignment of John's Social Security and pension = $50,149.
- Total cost of care in year 5 is **$44,466** (SS and pension of $50,149 − tax savings of $24,732 + lost interest of $19,049).

Asset Comparison

Liquid assets going into year 6			
Qualified funds	$0*		
Roth	$330,176**		
Total		$330,176	
Protected assets going into year 6			
NQ first annuity	$1,070,581†		
NQ second annuity	$802,936††		
Total		$1,873,517	
Total assets			$2,203,693
Portfolio value at inception of John needing care			$2,080,000
Difference			**$123,693** gain over 5 years

Analysis

1. The strategy (Roth distribution and medical deduction) created less taxable income, reducing the effective tax rate from 22% to 12% to 10% and now to 0%.
2. The cost of care reduced the portfolio by $33,103, allowing the initial portfolio value to grow $123,693 since inception ($2,203,693 − $2,080,000).
3. The fund reduction cost the portfolio $19,049 in potential interest.
4. Cost of care in year 5 is **$44,466**.
5. Overall cost of care to date is **$120,970**.
6. Investment response:
   A. *Qualified funds: $0.
   B. **Roth: $420,657 – $22,242 − 10,861 − $74,067 − $2,000 = $311,487; + 6% growth ($18,689) = $330,176
   C. Roth income annuity: $47,170 x 5 years remaining = $235,850.

D. †NQ first annuity: $1,009,982 + growth of 6% = $60,599; new balance = $1,070,581.
E. ††NQ second annuity: $757,487 + 6% growth (= $45,449) = $802,936.

Five Year Long-Term Care Investment Impact

5B, Option 1

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$18,000	$1,080 x 5 yrs. =	$5,400	$324 x 5 yrs. = $1,620
2	$29,000	$1,740 x 4 yrs. =	$6,960	$418 x 4 yrs. = $1,672
3	$30,000	$1,800 x 3 yrs. =	$5,400	$324 x 3 yrs. = $972
4	$31,000	$1,860 x 2 yrs. =	$3,720	$223 x 2 yrs. = $446
5	$192,000	$11,520 x 1 yr. =	$11,520	$691 x 1 yr. = $691
Total	$300,000	$18,000*	$33,000	$5,401

*Interest represented in Scenario 3, years 1-5

5B Option 2

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$18,000	$1,080 x 5 yrs. =	$5,400	$324 x 5 yrs. = $1,620
2	$29,000	$1,740 x 4 yrs. =	$6,960	$418 x 4 yrs. = $1,672
3	$30,000	$1,800 x 3 yrs. =	$5,400	$324 x 3 yrs. = $972
4	$31,000	$1,860 x 2 yrs. =	$3,720	$223 x 2 yrs. = $446
5	$28,229	$2,812 x 1 yr. =	$2,812	$169 x 1 yr. = $169
Total	$136,229	$9,292*	$24,292	$4,879

*Interest represented in Scenario 3, years 1-5

5B Option 3

End of Year	Direct Cost	5-Year Interest Impact		6% Compounding Interest
1	$18,000	$1,080 x 5 yrs. =	$5,400	$324 x 5 yrs. = $1,620
2	$29,000	$1,740 x 4 yrs. =	$6,960	$418 x 4 yrs. = $1,672
3	$30,000	$1,800 x 3 yrs. =	$5,400	$324 x 3 yrs. = $972
4	$31,000	$1,860 x 2 yrs. =	$3,720	$223 x 2 yrs. = $446
5	$50,149	$17,662 x 1 yr. =	$19,049	$1,143 x 1 yr. = $1,143
Total	$158,149	$24,142*	$40,529	$5,853

*Interest represented in Scenario 3, years 1-5
Note: 5-year interest impact is high due to the type of annuity used to create the income, which was necessary to comply with Medicaid.

Five Year Impact of LTC on Taxable Income and Tax

5B, Option 1

End of Year	Taxable Income without/with LTC	Taxes without/with LTC	Tax Difference*	Impact
1	$134,750/ $101,756	$24,123/$22,386	−$1,737	Positive
2	$135,345/ $101,396	$24,254/$22,307	−$1,947	Positive
3	$135,345/ $63,749	$24,454/ $7,650	−$16,804	Positive
4	$135,345/ $59,208	$24,592/ $7,105	−$17,487	Positive
5	$137,518/−$144,518	$24,732/ $0	−$24,732	Positive
Total			**−$62,707**	Positive

*Difference between the income tax without the need for LTC and the income tax with LTC costs and medical deductions.

SNF-5B, Option 2

End of Year	Taxable Income without/with LTC	Taxes without/with LTC	Tax Difference*	Impact
1	$134,750/$101,756	$24,123/$22,386	−$1,737	Positive
2	$135,345/$101,396	$24,254/$22,307	−$1,947	Positive
3	$135,345/ $63,749	$24,454/ $7,650	−$16,804	Positive
4	$135,345/ $59,208	$24,592/ $7,105	−$17,487	Positive
5	$137,518/ −$2,667	$24,732/ $0	−$24,732	Positive
Total			**−$62,707**	Positive

*Difference between the income tax without the need for LTC and the income tax with LTC costs and medical deductions.

SNF-5B, Option 3

End of Year	Taxable Income without/with LTC	Taxes without/with LTC	Tax Difference*	Impact
1	$134,750/$101,756	$24,123/$22,386	−$1,737	Positive
2	$135,345/$101,396	$24,254/$22,307	−$1,947	Positive
3	$135,345/ $63,749	$24,454/$7,650	−$16,804	Positive
4	$135,345/ $59,208	$24,592/$7,105	−$17,487	Positive
5	$137,518/ −$2,667	$24,732/$0	−$24,732	Positive
Total			**−$59,707**	Positive

*Difference between the income tax without the need for LTC and the income tax with LTC costs and medical deductions.

SNF Investment and Tax Impact Comparison

5B, Option 1

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $275,694 ($300,000 + $33,000 + $5,401 − $62,707), or 13.25%. Relatively, if John and Mary's investment portfolio was half its value ($1,040,000), the effect would be 26.50%. If their portfolio was $500,000, they would have spent 55.14% of their assets. Due to the negative impact, the portfolio experienced a loss below the initial value prior to John needing care.

5B, Option 2

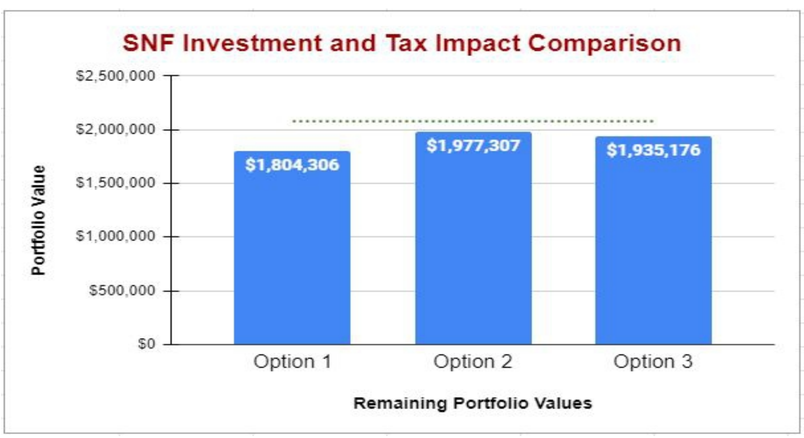
The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $102,693 ($136,229 + $24,292 + $4,879 − $62,707), or 4.94%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be 9.87%. If their portfolio was $500,000, they would have spent 20.54% of their assets.

5B, Option 3

The LTC costs and related concerns (tax and growth) negatively affect the investment portfolio by $144,824 ($158,149 + $40,529 + $5,853 − $59,707), or 6.96%. Relatively, if their investment portfolio was half its value ($1,040,000), the effect would be 13.92%. If their portfolio was $500,000, they would have spent 28.96% of their assets.

The graph below demonstrates the three options and the negative impact of John's needing care and entering a skilled nursing facility had on the portfolio. The graph illustrates the three options as detrimental to the portfolio, showing no growth accumulation above the initial portfolio value during this period, even though the portfolio earned an average of 6% annually.

Figure 19



Examining all three options

- Option 1 is the least desirable option.
- Option 2 places control with Medicaid.
- Although option 3 costs $42,131 ($144,824 − $102,693) more than option 2, it maintains control outside Medicaid.

NOTES

1. Internal Revenue Code of 1986, as amended.

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3. National Association of Insurance Commissioners, *A Shopper's Guide to Long-Term Care Insurance*, 2019, accessed July 13, 2021, https://www.naic.org/documents/prod_serv_consumer_ltc_lp.pdf.

4. Aging Care website, Senior Health: Discussions page, "Thirty Percent of Caregivers Die before the People They Care for Do," accessed October 7, 2021, https://www.agingcare.com/discussions/thirty-percent-of-caregivers-die-before-the-people-they-care-for-do-97626.htm.

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5. "Program of All-Inclusive Care for the Elderly," Medicaid website, accessed September 23, 2021, https://www.medicaid.gov/medicaid/long-term-services-supports/program-all-inclusive-care-elderly/index.html.

6. Karen Demasters, "Long-Term Care Cost Increases Outpace Inflation," Financial Advisor, September 28, 2017, https://www.fa-mag.com/news/long-term-care-cost-increases-outpace-rate-of-inflation-34934.html.

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