



American Private Wealth
781-300-7777
www.AmericanPrivateWealth.com

American
PRIVATE WEALTH®

Long-Term Care Annuities



The prospect of paying costly premiums for long-term care insurance that you might never use might discourage you. Enter the long-term care annuity.

When planning for the potential cost of long-term care, you've probably considered long-term care insurance. But premiums can be expensive and if you do buy the coverage, you probably hope you never have to use it. The prospect of paying costly premiums for long-term care insurance that you might never use might discourage you. Enter the long-term care annuity.

What is it?

This hybrid product, offered by insurance companies, is a nonqualified annuity that provides long-term care benefits (it can't be used with IRAs or employer-sponsored qualified retirement plans). These policies allow you to use the annuity proceeds for long-term care, and if you don't use the long-term care benefit, you still have typical annuity options. For instance, you can convert the annuity to a stream of income payments (annuitization), redeem the annuity at its maturity (e.g., cash in the annuity), or, at your death, you can pass the remaining balance of your annuity to your named beneficiaries.



While policy provisions may differ from company to company, generally you put money into the annuity, usually in a lump sum or through a series of premium payments. You may also exchange another annuity or cash value life insurance for a long-term care annuity via a Section 1035 exchange. The annuity typically pays a fixed rate of interest each year. In addition, the annuity provides a long-term care benefit amount, usually equal to two or three times your annuity cash value, subject to a maximum benefit period, which is the maximum length of time that you may receive long-term care benefit payments from the annuity. Long-term care annuity benefits are usually paid monthly. There is usually a charge for the long-term care component (generally ranging from 0.4% to 1.25% of the annuity's cash value) that is deducted from your annuity each year.

How does this product work?

Typically, long-term care annuities have the same

qualification requirements as most stand-alone long-term care insurance policies. You first have to be considered "insurable" by the annuity company, which means you have to answer questions relating to whether you have suffered any major illness such as cancer or heart disease, or whether you have a significant cognitive impairment like Alzheimer's disease. But you usually don't have to undergo a physical, and the underwriting is generally less stringent than with stand-alone long-term care insurance, meaning it's a little easier to qualify for the long-term care annuity.

Like most stand-alone long-term care policies, in order to be eligible for long-term care benefits from the annuity, you must either suffer from cognitive or mental incapacity or be unable to perform at least two of six activities of daily living that include feeding, bathing, dressing, transferring, continence, and toileting. Thereafter, benefits are typically available after a waiting period of between 30 days and 2 years (depending on the particular product).

Example: Say you pay \$75,000 to purchase a long-term care annuity. You select a long-term care benefit equal to 200% of your annuity's cash value, with a 5-year benefit period. Initially, your long-term care benefit equals \$150,000 ($\$75,000 \times 2$). Let's assume the annuity earns 4.5% per year and the cost of the long-term care provision is 0.5% per year. At the end of 20 years (presuming you take no withdrawals) the annuity is worth about \$163,622 and the long-term care benefit amount is \$327,244. This will provide maximum long-term care benefit payments of \$5,454 per month for as long as 5 years. And even if cumulative long-term care payments exceed the annuity's contract value (\$163,622), the long-term care payments will continue until you either exhaust the long-term care benefit amount (\$327,244) or you no longer need long-term care. (This is a hypothetical example. It does not represent a specific product. Product terms and conditions may differ. Check with the annuity issuer for specific product details.)



An advantage of stand-alone long-term care insurance over a long-term care annuity is the fact that the medical expense deduction is not allowed for long-term care charges within an annuity, while premiums for a stand-alone LTCI policy may be deductible as a medical expense, subject to IRS rules and limitations.

What about taxes?

Generally, withdrawals from an annuity are considered to come from earnings first and are subject to income tax. With respect to long-term care annuities in particular, prior to 2010, payments of long-term care benefits from annuities were also deemed to have been taken from annuity earnings first, then principal. Thus, each long-term care benefit payment was taxed as ordinary income to the annuity owner until all earnings within the annuity had been exhausted.

Beginning January 1, 2010, potentially favorable tax treatment applies to certain withdrawals from annuities purchased after 1996, if the withdrawals are used to pay for qualified long-term care insurance coverage. This means you won't have to pay income tax on the benefits you receive from your long-term care annuity used to pay for long-term care expenses.

More on exchanges

Prior to 2010, you couldn't exchange your annuity for a long-term care insurance policy without incurring income tax on the earnings portion of the annuity. Now you can exchange your deferred annuity for either a stand-alone long-term care insurance policy or a long-term care annuity on a tax-free basis. However, with any exchange, be sure your current annuity has reached maturity before exchanging it; otherwise surrender charges may reduce your current annuity's value. Also, if you exchange your current annuity for a long-term care annuity, you will likely incur a new surrender charge period that accompanies the new long-term care annuity. Surrender charges may apply to withdrawals you take from your annuity. However, surrender charges generally do not apply to long-term care benefit payments. Before entering into an exchange, you should talk to your financial professional or tax professional to be sure the exchange will be tax free.

Pluses/minuses

As with most insurance products, there are pluses and minuses to consider in determining whether a long-term care annuity is right for you. On the plus side:

- Long-term care annuities allow for tax-free withdrawals if used to pay for qualified long-term care coverage
- With typical long-term care insurance, if you don't use the coverage, you generally don't get a return

of your premiums; but with a long-term care annuity, at your death you can pass any remaining annuity balance to your beneficiaries

- If you're not in the best of health and you want some long-term care protection, you might not be able to qualify for stand-alone long-term care insurance. But, it's generally easier to qualify for a long-term care annuity (e.g., you probably won't need a physical)
- Once you put money in the annuity, you don't have to make any more premium payments as you would with stand-alone long-term care insurance policies

On the other hand:

- Most long-term care annuities are funded with a single premium payment of at least \$50,000, so you may need to have at least that much available in a lump sum
- Long-term care annuities, like most deferred annuities, come with surrender charges, so taking money out of the annuity that's not used for long-term care expenses may be subject to surrender charges, income tax, and a penalty of 10% if taken before age 59½
- Currently, long-term care annuities do not qualify as partnership plans, which otherwise afford some asset protection when trying to qualify for Medicaid
- If you don't deposit enough money into the long-term care annuity, you may not have enough protection to cover your long-term care expenses
- There's a cost to purchase the long-term care benefit which can range from 0.4% to 1.25% of the annuity's account value
- Since the cost of the long-term care portion of the annuity is deducted from your investment in the annuity (and not the earnings), you can't take the cost of long-term care as a medical expense deduction

Is it right for you?

Whether a long-term care annuity is right for you depends on a number of factors. But the long-term care annuity is certainly a viable option available for long-term care planning that might merit a second look.

IMPORTANT DISCLOSURES

Broadridge Investor Communication Solutions, Inc. does not provide investment, tax, or legal advice. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable—we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.