Incorporating Long-Term Care and Estate Planning Into Ultimate Life Insurance Trusts

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As a planner, how can you guide your clients on the need for appropriate long-term care (LTC) insurance coverage with premiums significantly increasing and several insurers departing the LTC business over the last several years?

Strategize ahead to ensure that your clients do not have to potentially draw down their estates for unexpected and prolonged LTC events. Your high-net-worth clients who self-fund LTC costs may face the unintended consequences of leaving less of a legacy to their children if out-of-pocket care expenses deplete their estates.

Current LTC Strategies

Most importantly, you should be selective with solutions for LTC coverage and seek more flexibility than what is typically offered with the features of traditional LTC policies. Ascertain that there is suitable due diligence for these LTC alternative solutions, so their functionality and complexities are clearly understood.

A hybrid or linked-benefit life insurance policy is one alternative solution. This kind of life insurance policy pairs the benefits of a life insurance policy with that of a traditional LTC policy. Note that these benefits can be typically accessed through LTC riders or accelerated death benefit for chronic illness riders, depending on how the insurance policy is designed.

Talk to your clients who already have ample savings to cover LTC, since they can use the life insurance to create a tax-free bucket. This hybrid or linked-benefit life insurance policy eliminates the risk inherent in traditional LTC policies for clients who pay prodigious premiums for coverage they hope to never use. By combining life insurance with LTC benefits, you can lock-in a payout for your clients' spouses, kids, or their other designated heirs, even if they don't use the LTC benefits.

However, a caveat of these hybrid policies is that they present added challenges for your higher-net-worth clients and families who may be above the estate tax exclusion amount. Be mindful that these hybrid policies, if purchased under the insured client's name, will have death benefit proceeds subject to inclusion for estate tax calculations, resulting in added tax liability.

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ULITs Enhance Flexibility

An ultimate life insurance trust (ULIT) is an innovative solution that may better fit your overall planning strategy for clients with possible estate tax liabilities. The ULIT is a life insurance policy owned by a specific type of irrevocable life insurance trust (ILIT). In tandem with a LTC rider that pays indemnity benefits, this ULIT may be employed to fund LTC needs while maintaining the goal of providing funds for estate tax expenses. In conjunction with the counsel of a seasoned trust attorney, you can structure an ILIT arrangement to optimally provide your clients with vital asset protection. For instance, stipulations can be devised for the ILIT's death benefit to be paid into the trust, if the insured never files a claim or uses only part of the policy's LTC benefit during his or her lifetime.

Inform your clients that although the trust cannot directly pay the LTC expenses of an insured, the ULIT can contain a provision to permit it to lend the insured money. In essence, a ULIT is a "defective trust" that allows the insured to access funds from the trust using arm's length, fully collateralized loans that are charged an interest.

Recognize that this loan is backed by an agreement to fully pay back the debt, with the incurred interest either allowed to accumulate in the trust or to be paid back prior to the death of the insured to avoid taxation. Any remaining life insurance death benefit would be paid to the trust by the insurer with the insured's estate repaying the loan outstanding to the ULIT before estate taxes are determined. Subsequently, the trust assets, including the life insurance proceeds and the repaid loan and interest, could be distributed income tax-free to the trust beneficiaries or be used to pay estate taxes and any other obligations.

The ability for the trust to create fully collateralized loans, as an unrelated transaction to the grantor who may happen to also be insured, is pivotal to making this strategy work for your clients. Further, your grantor clients avoid triggering incidents of ownership.

Keep in mind that the money paid by the insurance policy should never be received by the insured directly; rather, the ULIT receives LTC benefits as additional funds to the trust. Your clients' trustees can then decide to create fully collateralized loans to the insured or let the insured pay care expenses, which may directly diminish the value of their estate assets. The latter option provides the trustees with planning flexibility to reinvest the funds in the trust, hold them for a future distribution, or even distribute the funds as an early inheritance to the beneficiaries.

Advise your clients that the choice of ULIT trustee(s) is pivotal. The insured will need a ULIT trustee(s) who is adaptable to being removed by the grantor to avoid incidents of ownership. In addition, the insured should appoint ULIT trustee(s) who will be responsible and sensitive to managing your clients' LTC needs.

Educate your grantor clients on the importance of not directing the ULIT to use LTC insurance benefits to cover their expenses. Be cognizant that this instruction may be regarded as a retained interest in the trust, resulting in the inclusion of trust assets in the estate for estate tax purposes.

Value-Added Estate Planning

Be mindful that the LTC benefits should be indemnity plans and not reimbursement plans for this ULIT strategy to accomplish multiple protection needs in a tax-efficient manner. Your clients are permitted to place the insurance policy in an irrevocable trust and still use the accelerated death benefit for LTC bills. Consequently, when your grantor clients pass away, their descendants receive the remainder benefit free of estate tax.

Note that an indemnity plan benefit is paid to the owner of the policy, which is the trust. This trust may be disqualified if these LTC benefits are paid directly to the insured.

Review your clients' LTC insurance policy benefits, recertification of claims, maximum benefit amounts, and details related to LTC coverage to ensure they are suitable for the insured's needs and compatible with the ULIT strategy. Engage experienced and qualified estate planning attorneys to draft your clients' legal documents and specify provisions in accordance with these relatively new insurance solutions. ■