

# THE BERNSTEIN TAX LETTER

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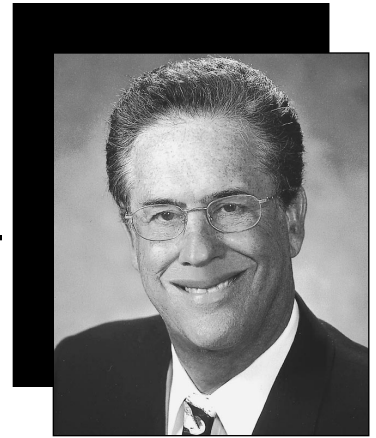
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Dear Reader,

The change in Congress is expected to have some impact on tax legislation. However, nothing extraordinary is anticipated because the Republicans have enough votes in the Senate to cause procedural problems with any legislation, and there are not enough Democratic votes to override a Presidential veto in any event. There does not seem to be any momentum for a substantial overhaul of the tax system, although many legislators and practitioners believe significant reform is needed. A major confrontation is expected in a couple years when the sunset of most tax relief provisions of the 2001 and 2003 laws is on the horizon.

One frequently discussed item of reform is the alternative minimum tax (AMT). Although most legislators view this tax as a monster, slaying it presents a problem. Complete repeal of the AMT is estimated to cost between \$850 billion and \$1 trillion, and offsetting that amount is difficult to imagine with the current deficit estimates. The political fallout of not providing more relief is also significant. Maintaining current AMT exemption levels would burden an additional 500,000 taxpayers with the implications of AMT. Hence, the previous stopgap solution has been gradually to increase the exemption levels.

The House passed a phase-in for an increase in the minimum wage to \$7.25 per hour. Senator Baucus added a package of small business tax breaks to the Senate version estimated at \$8 billion to \$10 billion in savings. It seems likely that some bipartisan support will be available for this measure.

The IRS issued Notice 2007-7 to provide guidance with respect to the numerous changes in the Pension Protection Act highlighted in an earlier edition of this letter. Unfortunately, the provision for rollover to an IRA of benefits from a qualified retirement plan to a nonspouse beneficiary has not been interpreted as flexibly as practitioners had hoped.

Cordially,

A Second Opinion Costs You **NOTHING**,  
But Could Save You **MILLIONS!**

WHEN IT COMES TO YOUR HEALTH, YOU GET A SECOND OPINION,  
SHOULD YOUR FINANCIAL WEALTH BE ANY DIFFERENT?

# THE GROWING PROBLEM OF LONG-TERM CARE EXPENSES

## WHAT IS LONG-TERM CARE?

Long-term care (LTC) is care an individual requires due to a prolonged illness (generally more than 90 days), disability, mental deterioration, or frailty. The care may be *skilled*, requiring medical professionals (such as nurses) under the supervision of a physician for 24 hours per day or something less intensive. *Intermediate care* is needed for conditions that require daily but not 24-hour nursing supervision. Physical, occupational, and speech therapy are often included in intermediate care. *Custodial care* helps a person perform activities of daily living, which include assistance with eating, bathing, dressing, toileting and transferring, and other routine tasks. LTC is provided by home health care agencies, senior centers, adult day care centers, traditional nursing homes, assisted-living facilities, and continuing care retirement communities. In addition, family members often serve as personal caregivers to provide some or all long-term care needs.

## MAGNITUDE OF LONG-TERM CARE NEEDS

Surveys have revealed some interesting facts about long-term care. In a recent survey, 75 percent of individuals aged 35 to 54 responded that they had no idea of the costs of LTC. Indeed, 70 percent of those surveyed indicated their largest financial retirement fears were high health care costs and inadequate retirement income. Approximately 20 percent of individuals over age 65 need some assistance with their daily activities. This increases to 50 percent at age 85 and over. It is currently estimated that 40 percent of individuals over age 65 will require nursing home care someday, and about 13 percent will stay in the nursing home 5 or more years (although the average nursing home stay is currently less than 3 years). As medical advances continue to increase our life expectancy, it is likely these statistics will worsen. Interestingly, this is not only a "senior" issue because 40 percent of those who currently need long-term care are adults between ages 18 and 64.

The costs are significant and vary dramatically depending on geography and the amount and type of care provided. In 2006, the national average daily rate for a private room in a nursing home was \$206, or \$75,190 annually (for example, \$578 per day in Alaska and \$120 per day in Louisiana). Also, in 2006, the average cost nationally for a private room in an assisted-living facility was \$32,294 per year (about \$89 per day), while the average hourly rate for a home health aide was \$25.32 per hour. In addition, costs of this type of care are increasing more than 5 percent annually.

## COVERAGE UNDER MEDICARE

There is a prevalent misconception that Medicare will cover long-term care expenses. In fact, although Medicare does provide significant comprehensive benefits for acute care, its long-term care coverage is fairly limited. Medicare generally pays for a nursing home in full for only 20 days. A period of up to 80 additional days may be available with a \$124 daily co-payment (in 2007). A hospital stay of at least 3 days is required within the prior 30 days before the patient enters the nursing home. The benefit is available only if a physician certifies that skilled nursing care or rehabilitation services are required. In addition, the Medicare benefit is terminated if the patient is not improving under the rehabilitation. This benefit is not available for custodial care or

care in an assisted-living facility. Although Medicare does have extensive home care coverage for nursing or therapy services, it does not provide coverage for assistance with normal activities of daily living.

## **COVERAGE UNDER MEDICAID**

Medicaid is a program provided jointly by federal and state governments. Most administration is handled at the state level, and some significant variation exists. State budgets have created a squeeze, and many programs are administered strictly. States have a right to recover assets from the estate of an individual who received benefits; some states have aggressively pursued such estates, even taking the family home. In some states, children, even if they reside elsewhere, can be held accountable for parents' Medicaid-paid nursing home bills.

The Medicaid qualification rules are complex and differ from state to state. Normally, an individual (together with his or her spouse) is able to keep certain exempt assets (such as the primary residence) and a small amount of nonexempt assets. If an applicant is trying to qualify for Medicaid, the look-back period for transfer of assets is now 5 years. New legislation also denies Medicaid coverage for nursing home care to any applicant with home equity above \$500,000 (\$750,000 in some states). In 2007, the maximum allowable amount of nonexempt assets that the community spouse can keep is \$101,640, and this figure is lower in many states. Depending on the state and whether or not the applicant is married, a monthly income of as little as \$1,869 may disqualify him or her from receiving Medicaid benefits. In addition, Medicaid will not pay for care in assisted-living facilities and pays on a very limited basis for home health care. Because nursing homes receive lower reimbursement per patient from Medicaid than from private-pay patients, the number of beds available for Medicaid patients may be limited. This could present a problem for an individual who wants care in a specific facility.

## **LONG-TERM CARE INSURANCE COVERAGE**

Long-term care insurance (LTCI) is a contract between a buyer and an insurance company. For the required premium payments, the company promises to pay for the covered cost of long-term care when needed, up to the policy limits. LTCI helps pay the cost of services for people who have a prolonged physical illness, an extended disability, or cognitive impairment. The LTCI plan can preserve a person's independence and dignity by allowing the freedom of choice to receive care at home, in an adult day care center, or in a facility of the individual's or family's choice. Generally, to qualify for care under the terms of the policy, a health care practitioner must certify the following:

- It is likely that the individual will need care for at least 90 days.
- The individual needs assistance because of either (1) an inability to perform two of the six activities of daily living (dressing, bathing, toileting, eating, transferring, continence) or (2) has substantial cognitive impairment (memory loss, dementia, or Alzheimer's).

Some important considerations in selecting an LTCI policy are as follows:

- What daily benefit amount should be purchased (for example, \$150 per day)?
- Should inflation protection be included, and if so, what type (CPI, simple, or compounded)?

- What benefit period should be selected (for example, should care be limited to 3 or 4 years, or should the policy have an unlimited benefit period for care)?
- How long an elimination period should be chosen? Similar to deductibles, an elimination period or waiting period is the number of days (for example, 90 days) that the cost of care must be paid out-of-pocket before the LTCI policy begins payment of benefits.

LTCI enjoys favorable tax treatment. The LTCI policy must be “tax qualified,” which means that it is written to comply with the provisions of the law. Almost all LTCI policies sold today are tax-qualified policies. Those sold before 1996 are grandfathered. Premiums paid for tax-qualified plans can be itemized as deductions for medical expenses (the same as for other health insurance premiums). The annual dollar limits for the 2007 tax year range from a \$290 deduction for an individual aged 40 or under up to \$3,680 per year for someone aged 71 or older. Medical expense deductions are currently limited to the excess over 7.5 percent of a taxpayer’s adjusted gross income (AGI). Generally, benefits received under a tax-qualified LTCI policy will be excluded from AGI and therefore are nontaxable. LTCI can also be offered to employers on a tax-advantaged basis and is particularly beneficial to owners of C corporations or professional corporations.

Finally, an important consideration for the future is a state’s LTC partnership program created by recent federal legislation. Under the plan, qualified LTCI policy benefits will enable the insured to protect more assets for a Medicaid applicant. Only a handful of states currently have a partnership program, but many are considering how to implement the federal legislation. Undoubtedly, there will be specific policy requirements that insurers will have to provide in a qualified policy, and exchanges of existing policies may be necessary. However, this represents an additional opportunity for a family concerned about long-term care costs to protect assets with a suitable LTCI policy.

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This Tax Letter is intended to assist you to conserve your estate and to protect the interests of your family and business associates. Estate planning involves the joint services of a competent Trust Officer, Attorney, Accountant, and Life Underwriter. The experience and advice of each is generally essential.

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