

THE BERNSTEIN REPORT

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Dear Reader,

The President's Budget was released at the beginning of the month and it proposes a new job stimulus plan that will be the subject of Congressional debate by the time you read this letter. The document is 192 pages and projects a deficit of over \$1.5 trillion in fiscal year 2011. Afterwards, the forecast deficits drop, but remain at high levels for a full decade. This will limit flexibility with respect to government programs and tax policy.

Some of the details included in the Budget proposal were mentioned in the State of the Union address and a few proposed tax changes were included. First, a Financial Crisis Responsibility Fee would be imposed on financial firms (with assets in excess of \$50 billion) for at least 10 years. Second, the carried interest earned by investment managers would be taxed as earned income rather than at capital gains rates. Third, the tax cuts from the Bush Administration would be allowed to expire for families with income over \$250,000. Finally, the tax benefits of itemized deductions for taxpayers with income over \$250,000 would be reduced to the levels in place at the end of the Reagan Administration. It is important to mention at this point that many tax items in such Budgets in the past never got serious consideration in Congress.

The Budget addressed some items with respect to estate planning. There was mention of a few things that have been on the Treasury's hit list for the last few years. Notably, changes to valuation methods would be imposed to provide consistency between the wealth transfer and income tax systems. There would be greater limitations for some aggressive valuation discounts through family limited partnerships and grantor-retained annuity trusts (GRATs). There is also a proposal to ensure compliance for income-tax purposes with respect to taxpayers involved in life settlements of life insurance policies.

Our last letter discussed the problems created by the failure of Congress to address the estate-tax repeal/reform issue before the end of 2009. President Obama has consistently supported a freeze of the system at the 2009 levels without revenue offsets. Despite promises by some key Senators to deal with this in early 2010, it appears now that this issue will probably not get serious consideration until later in the year.

Cordially,

Richard S. Bernstein

**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

The Health Care reform has lost momentum and may not come to fruition. It contained surprisingly little about the potentially devastating costs of long-term care needs. There is a bill (The CLASS Act--Community Living Assistance Services and Support) that was introduced by the late Senator Kennedy that would address some of the concerns associated with long-term care, but its current prospects are uncertain.

What is Long-Term Care?

Long-term care is care an individual requires due to a prolonged illness (generally over 90 days), disability, mental deterioration or frailty. The care could be *skilled*, requiring medical professionals, such as nurses, under the supervision of a physician. The need might be 24/7 or something less intensive. *Intermediate care* is needed for conditions that require some skilled care, but not necessarily daily. Physical, occupational and speech therapy are often included in the skilled care category. *Custodial care* helps a person perform activities of daily living which include assistance with eating, bathing, dressing, toileting and transferring and other routine tasks. It might also include supervision due to a cognitive impairment. Long-term care is provided by home health care agencies, adult day care centers, traditional nursing homes, assisted living facilities and continuing care retirement communities. Family members often serve as personal caregivers to provide some or all long-term care needs as well.

The Magnitude of Long-Term Care Needs

Surveys have revealed some interesting facts about long-term care. Approximately seventy-five percent of individuals age 35 to 54 responded that they had no idea of the costs of long-term care. 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 every day with their activities. This statistic 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 some day and about 13 percent will stay five or more years. Although, the average nursing home stay is currently less than three years. As medical advances continue to increase our life expectancy, it is likely these statistics could worsen. Interestingly, this is not only a "senior" issue since 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 upon geography and the amount and type of care provided. In 2009, the average daily rate nationally for a private room in a nursing home was \$219, or \$79,935 annually (from a high of \$584 per day in Alaska to \$132 per day in Louisiana). Also, in 2009, the average cost nationally for a private room in an assisted living facility was \$37,572 per year, while the average hourly rate for a home health aide was \$21 per hour. In addition, costs of this type of home 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 skilled nursing home care in full for only 20 days. A period of up to 80 additional days may be available with a \$137.50 daily co-payment (in 2010). In addition, Medicare requires a hospital stay (for a condition that causes need for the nursing

home) of at least three days within the prior 30 days before entering 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 either not improving under the rehabilitation or no longer requires skilled services on a daily basis. 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 solely for assistance with normal activities of daily living.

Coverage Under Medicaid

Medicaid is a program jointly provided 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. They have a right to recover assets from the estate of an individual who received benefits and some states have aggressively pursued such estates—even taking the family home. Also, 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 vary from state to state. Normally, an individual (together with the spouse) is able to keep certain exempt assets (such as the primary residence) and a small amount of non-exempt assets during lifetime. If an applicant is trying to qualify for Medicaid, the look-back period for transfer of assets is 5 years. Medicaid coverage for nursing home expenses is also denied to any applicant with home equity above \$500,000 (\$750,000 in some states). The maximum allowable amount of non-exempt assets that can be kept by the community spouse is \$109,560, and this figure is lower in many states. Depending upon the state and whether or not you are married, a monthly income of as little as \$1,821 may disqualify one from receiving Medicaid benefits. In addition, in most states, Medicaid will not pay for care in assisted living facilities and pays on a very limited basis for home health care. Since 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 the 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 an extended physical or cognitive impairment. The LTCI plan can protect 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, in order to qualify for care under the terms of the policy the following criteria must be met:

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

Some important considerations in selecting an LTCI policy include:

- What daily/monthly benefit amount should be purchased (e.g. \$150 per day)?
- Should inflation protection be included, and if so what type (automatic CPI, simple or compounded)?

- What benefit period should be selected (e.g. should care be limited to three or four 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 (e.g. 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 it is written to comply with the provisions of the law. Almost all LTCI policies being sold today are tax-qualified policies. Those sold before 1997 are grandfathered. Premiums paid for tax qualified plans can be itemized as deductions for medical expenses—the same as other health insurance premiums. The annual dollar limits for the 2010 tax year range from a \$330 deduction for an individual aged 40 or less, up to \$4,110 per year for someone 71 years old 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 non-taxable. LTCI can be offered through employers on a tax-advantaged basis and is particularly beneficial to owners of regular (C) corporations or professional corporations. For self-employed individuals, the tax benefits for a policy covering the self-employed individual and his or her spouse are available on the individual income tax return for properly structured coverage.

Finally, also important is the opportunity created under a state's long-term care partnership program. Under such programs, qualified LTCI policy benefits will enable the insured to protect a greater level of assets for a Medicaid applicant. Most states currently have a partnership program. There are specific policy requirements that insurers will have to provide in a qualified policy and exchanges of existing policies may be required. This may or may not require new underwriting. However, this represents an additional opportunity for a family concerned about long-term care costs to protect assets with a suitable LTCI policy.

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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