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LONG-TERM CARE INSURANCE

Long-term care includes a wide range of services for people who have chronic health problems and who cannot perform the activities of daily living. Long-term care insurance (LTCI) may cover part or all of the cost of those services.

A person with a chronic physical illness, such as a stroke or emphysema, may not be able to perform such activities of daily living as bathing, toileting, dressing and eating. A person with a chronic mental illness, such as Alzheimer's disease, may have severe cognitive impairment that could threaten his or her own or someone else's safety. Both groups of people may need long-term care quite different from the medical or nursing care provided for temporary physical illnesses or injuries.

Long-term care takes place in nursing homes, assisted living facilities, adult day care centers, and at home. There are generally two types of long-term care: skilled care by a registered nurse or physical therapist, and custodial care to assist a person with the activities of daily living.

Medicare and Medicaid do cover some of the costs associated with long-term care. Medicare will pay up to 100 days of care in a qualified skilled nursing facility following a hospital stay of at least three consecutive days. However, Medicare is designed for skilled medical and nursing care of acute physical illnesses, not the long-term custodial care for chronic disabling physical or mental illnesses.

Medicaid pays for long-term care, but only if the person in need of care is impoverished – in most cases, single patients can have no more than \$2,000 in nonexempt resources. In addition, the individual must contribute a sizable portion of his or her income towards the cost of care.

The National Association of Insurance Commissioners (NAIC) (www.naic.org) in "A Shopper's Guide to Long-Term Care Insurance" warns that an individual should be careful about purchasing LTCI if he or she cannot afford the premiums, has limited assets, receives only a Social Security benefit or Supplemental Security Income (SSI) as income, and has trouble paying for utilities, food, medicine, or other important needs.

LTCI may, however, be attractive to persons with enough income and other assets to comfortably pay the premiums and who wish to protect themselves from the possibility of depleting their assets to the point that they become financially dependent upon others.

A typical LTCI policy will pay benefits when the insured person cannot perform two or more activities of daily living or has a severe cognitive impairment requiring institutional and home-based care. The main variables in designing a policy are:

- The waiting period before benefits begin; usually 1, 30, 60, or 90 days. The cost of paying for long-term care during the waiting period must be weighed against the lower premium attributable to a longer waiting period.
- The length of time for which benefits will be paid, e.g., three years, six years, or life. The premium is highest for lifetime benefits and the increased cost must be weighed against the length of the benefit period.
- The amount of the daily benefit can greatly vary by city and geographical area and therefore the city and state where the long-term care is likely to be provided should be considered.
- Inflation protection; the benefits can be increased at a simple or compound rate, which in turn will increase the premium.
- The type of benefit payment; indemnity or cash benefit. Benefits can be paid for as expenses are incurred (indemnity) or can be paid in cash without the need to submit bills (cash benefit). The latter option permits payment to informal caregivers.

The following illustration may be helpful in applying the concepts outlined above.

A retired, 50 year old couple without children are concerned about possible long-term care needs. Their joint net worth is \$3,000,000 (mostly marketable securities) and their combined income from retirement plans is \$125,000. Protection against inflation may be particularly important for them because they are a number of years from the time when they are likely to receive long-term care. A sample policy design might be:

- Maximum daily benefit: \$200
- Waiting period: 90 days
- Benefit period: lifetime
- Five-percent compound inflation protection

The annual premium for this policy might be in the range of \$3,300.

The annual premium would be changed if any of the above features were changed:

- If the waiting period were reduced to 30 days, the premium would be increased by about \$500
- If the benefit period were reduced to three years, the premium would be reduced by about \$1,200
- If the inflation protection is changed from a compound to simple rate, the premium would be reduced by about \$1,000

Ultimately, the couple should consider their risk tolerance (i.e., how strongly do they want to insure against the risk of needing long-term care), their budget for LTCI premiums, where they

plan to retire and how much of their future income might be available for payment of long-term care costs.

Business owners should review with their tax advisors the special rules relating to the tax treatment of LTCI premiums paid by a business on its owners. While the tax treatment is somewhat complex and may be affected by a number of factors, essentially LTCI premiums are income tax deductible in varying degrees for self-employed individuals, partners and “S” corporation shareholders.

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