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Optimizing Long-Term Care Planning: The Case for Annuity-Based ABLTC Products

When evaluating funding strategies for Asset-Based Long-Term Care (ABLTC) solutions, it is crucial to account for taxation implications—especially when utilizing non-qualified annuities. The availability of a tax-free 1035 exchange can significantly impact the net premium available, altering the overall cost-effectiveness of the strategy.

Simplifying the Decision-Making Process

Clients benefit from a streamlined approach that covers key financial considerations without unnecessary complexity. However, one often-overlooked factor is the source of funds—whether they originate from non-qualified annuities, brokerage accounts, or other investment vehicles. The tax implications of each option play a vital role in determining the optimal care planning strategy.

The Advantage of Annuity-Based ABLTC Products

For non-qualified annuities, there is an opportunity to avoid a taxable event altogether by leveraging a tax-free 1035 exchange into an annuity-based ABLTC product. This method unlocks benefits under the Pension Protection Act, optimizing available funds and potentially increasing long-term care (LTC) benefits.

Tax Considerations and Their Impact

A common approach is to use an existing annuity's cash value as a single premium payment for an ABLTC solution. However, if this amount is liquidated to fund a life-based ABLTC product, applicable taxes must be deducted, reducing the effective premium available. This difference can have a material impact on the LTC benefits provided.

For example:

- Life-Based Premium (after-tax): \$166,000
- Annuity-Based Premium (tax-free 1035 exchange): \$200,000
- Shortfall: \$34,000 (20.48% reduction in available premium)

This difference in available premium directly affects the benefits received. Consider a case where a 70-year-old male with a couples discount, a 6-year benefit period, and a 3% COLA opts for an annuity-based versus life-based solution. Due to the tax impact, the annuity-based solution could provide an 11.15% higher monthly benefit at age 80.

Please see Table 2 for additional details:

Figure 1: Impact of Taxes on Non-Qualified Annuities

Product Type	Life-Based ABLTC Taxes Considered	Annuity-Based ABLTC Taxes Considered
Annuity CSV	\$200,000	\$200,000
Cost Basis	\$100,000	\$100,000
Income Tax Rate	34%	0%
Taxes Due ¹	\$34,000	\$0
Net Premium	\$166,000	\$200,000

¹ Tax Rate Assumptions: 24% Federal, 10% State, for a combined 34%

Figure 1 shows the significant difference in the net premium available to fund a care planning strategy with funds from a non-qualified annuity based on the type of ABLTC product being considered. While the full amount is available to an annuity-based product, the lower amount net of taxes is what is truly available to fund a life-based care planning strategy.

Additional Considerations

- Beyond monthly benefits, other factors influence the decision:
- Death Benefits – Life-based ABLTC products typically provide a larger, tax-free death benefit to beneficiaries.
- Liquidity – Annuity-based solutions may offer more flexibility in accessing funds.
- COLA Riders – While annuity-based products may initially project higher benefits, COLA riders on life-based products guarantee future benefit increases, ensuring protection against inflation.
- Underwriting – Annuity-based solutions may feature simplified underwriting, accommodating clients with certain health conditions.

Next Steps

To ensure a well-informed recommendation:

- Always calculate the net premium available by factoring in cost basis and applicable income tax rates when not utilizing a 1035 exchange.
- Compare both life-based and annuity-based proposals using accurate premium amounts.
- Consider split 1035 exchanges if an annuity's surrender value exceeds the required premium, optimizing fund allocation.

Understanding these tax implications is crucial to making the most of ABLTC solutions. Properly structuring the funding source can maximize client benefits, leading to better financial security in long-term care planning.

Figure 2: Impact of Taxes on LTC Benefits

Product Type	Life-Based ABLTC Taxes Not Considered	Life-Based ABLTC Taxes Considered	Annuity-Based ABLTC Taxes Considered
Annuity CSV	\$200,000	\$200,000	\$200,000
Cost Basis	\$100,000	\$100,000	\$100,000
Income Tax Rate	0%	34%	0%
Taxes Due ¹	\$0	\$34,000	\$0
Net Premium	\$200,000	\$166,000	\$200,000
Monthly Benefit @ 80	\$11,150	\$9,254	\$10,286
ROP/CSV @ 80	\$149,743	\$124,287	\$155,481
Death Benefit @ 80	\$199,113	\$165,264	\$155,481

¹ Tax Rate Assumptions: 24% Federal, 10% State, for a combined 34%

Figure 2 shows how case design is impacted by the source of funds. Not taking the taxes due on the surrender of the annuity into account could easily lead to a sub-optimal recommendation. At first glance, it appears that the life-base solution is superior. However, that design has a hidden cost of an additional more than \$34,000 in taxes as seen in the column titled Life-Based ABLTC, Taxes Considered.

This effectively reduces the amount available to fund the life-based strategy. A review of the additional two columns showing the impact of taxation point to the annuity as the superior solution in terms of monthly benefit. In this case, a monthly benefit at age 80 that is \$1,032 or 11.15% higher in an annuity-based solution.