Clarifying the misconceptions about LTC benefit models

Shawn Britt - CLU, CLTC
Director – Long-term Care Initiatives, Advanced Consulting Group

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There seems to be a lot of discussion lately as to which long-term care (LTC) benefit payment model is the best one, be it cash indemnity or reimbursement. So I would like to start out by stating that there is no one perfect LTC benefit model for all situations. Each individual or couple has their own unique circumstance to solve for, and what may be best for one individual or couple may not be the best for another.

The goal of this white paper is to the break down the following:
1. The basic definition of the primary LTC benefit payment models used today
2. Help determine which benefit model will work best for a particular situation
3. Clarify the myths and misconceptions of both LTC benefit models.

THE FIRST STEP IN CHOOSING LTC COVERAGE

When deciding on which LTC policy to purchase, the first consideration is to choose a benefit payment model that best suits the situation of a particular individual or couple. The care experience is what is most important, so homing in on a benefit model that will meet the needs of the care recipient and their family is top priority. Once that choice is made, it will automatically eliminate a number of insurance products that don't offer the chosen benefit model, making it easier to pin down the best policy for the situation.

DEFINING THE LTC BENEFIT PAYMENT MODELS

It might help to first lay out the basic definition of the two primary LTC benefit models used today. Once you have a basic understanding of how each benefit model works, it will be easier to see where each model fits as this discussion proceeds.

Reimbursement LTC Benefit Models

A reimbursement policy is purchased with an issued benefit amount (which could include inflation). Should the insured need LTC services and meets LTC claim qualifications, bills and receipts are sent in each month to the insurance company. A reimbursement will be made each month for expenses incurred that are covered under the policy contract, up to the daily or monthly amount of LTC benefits available.

Any expenses not covered under the policy contract must be paid for out of pocket, even if the expenses have not exceeded the available LTC benefit amount. Alternative care services must be approved by the insurance company and may not be covered.

Most reimbursement policies offer two choices of reimbursement.
1. **Reimbursement to the policy owner** - The policy owner can pay the care provider directly, and the send in bills and receipts for reimbursement up to the amount that qualifies under the policy.
2. **Direct reimbursement to the care provider** - The policy owner can opt for direct reimbursement to the care provider. Here, the care provider bills the insurance company directly for bills covered under the policy. Then, the policy owner is billed and pays the care provider for any services not covered or approved under the policy.

Cash Indemnity LTC Benefit Models

A cash indemnity policy is purchased with an issued benefit amount (which could also include inflation). Should the insured need LTC services and meets LTC claim qualifications, the insurance company pays the full available LTC benefit amount each month. The policy owner may ask for less to be sent if not all of the funds are needed, but they are entitled to receive the full available benefit amount if that is what they wish to receive.

Once the claim is approved, no monthly paperwork, such as sending in bills and receipts, is required. And LTC benefits can be used without restriction from the insurance company.

PLANNING FOR THE NEEDS AND CONCERNS OF A CARE SITUATION

We will delve into the pros and cons of both benefit models as well as discuss where each benefit model may offer the best fit. But before breaking down the LTC benefit payment models and how they operate, it might be good to address the types of questions and considerations individuals and couples might want to discuss. It boils down to two primary areas of discussion:

1. The type of care desired, where it would take place, and who would be the preferred caregiver
2. The financial aspects of managing a policy

Focusing first on these aspects of a LTC situation, and answering the related questions, will lead most people more easily to the appropriate LTC benefit model.

There are many reasons to think ahead about the type of care an individual would prefer. One good reason is that these wishes can be conveyed to family members in advance, so siblings and in-laws do not have to wonder or even argue about what mom or dad may prefer. However, there is another important reason to plan care wishes in advance, and that is to help purchase the type of LTC coverage that will best fit the individual or couple's needs.

Consider where you would want to receive care –

Where would you prefer to receive your care should you ever need help taking care of yourself? For example:

1. Would you prefer to remain in your own home or live with a family member?
2. Perhaps you might consider sizing down into a Continuous Care Retirement Community where you start out in an independent living environment. If the time comes to need care, you could either bring in home health care into your current residence; or move into the next level, where care can be provided within the community you are already accustomed to - such as assisted living or nursing home if needed.
3. Sometimes we have to relocate to another city when care is required. Would you move to be near your children? Or would your children be willing to move to be near to you?
4. Will you retire abroad and need to receive care out of the country?

These and more are all questions to consider as you picture *where* you may want to be residing when receiving care. And remember, this is your plan, so be creative as you wish in the beginning and see where that takes you.

Consider who you would want to provide your care –

Just as important is deciding *who* you want to provide your care. Some individuals consider having a family member provide care. But this can be uncomfortable when someone just assumes their children will take care of them. Can your daughter/son afford to reduce work hours or quit their job? What if you could pay them? Either way, adult children should be made aware of these expectations and have a chance to discuss the situation and offer other options. Family care should be a choice, not a necessity. The following are just a few of the ideas that could be considered as options for providing care.

1. Perhaps a person that is unlicensed but well referenced and thus less expensive?
2. Or would you feel more secure with a professional caregiver - whether at home or receiving care in a facility?
3. Would a combination of the above options be a possibility. It doesn't have to be all or nothing.
4. Maybe a form of alternative care such as a robot companion.?

Again, think creatively. Some policies and benefit models are more flexible than others, so answering these types of questions will be important in helping to determine the LTC benefit payment option and insurance company policy that may best suit your needs.

FACTS APPLYING TO THE BENEFIT MODELS – SETTING THE RECORD STRAIGHT

There is so much information out there - both good and bad - regarding the primary benefit models, that many people are totally confused. Again, I want to stress that no one insurance company or LTC benefit payment model is the right choice for every individual situation. Having choices is a good thing, and allows individuals and couples to choose a policy that will best meet both their financial and LTC objectives.

To accomplish the goal of creating a better understanding of the benefit models, we will look at both reimbursement benefits and cash indemnity benefits from three viewpoints:

- the advantages
- the disadvantages
- and the myths and misconceptions

Once there is a better understanding of all three factors, it should be easier to determine which LTC benefit model and insurance company policy will best fit individual situations.

ADVANTAGES OF THE LTC BENEFIT MODELS

Reimbursement Benefits

As we start with the advantages, keep in mind some advantages may only apply for certain LTC products, but not all. In such cases, the disadvantages will be discussed separately.

1. If you have a large benefit amount with LTC costs that are less than the maximum monthly benefit, your benefits may last for a longer period of time than purchased. However, this advantage may only be ideal for LTC riders on life insurance where the full death benefit will be paid - whether as LTC benefits, death benefits, or a combination of both.
2. A reimbursement policy can be useful when there is a concern with a spendthrift policy owner or spouse. Since only actual qualifying costs of care are reimbursed, regardless of the actual LTC benefit amount, there are no excess benefits paid that could potentially be mishandled.
3. Today, most reimbursement policies offer a direct billing option. This allows the care provider to directly bill the insurance company, eliminating the need for the policy owner or their family to submit bills each month. It might even eliminate the need to pay monthly bills, but that is assuming the policy covers every single billed service provided by the care service or facility - or needed by the insured from other covered providers. However, it is not quite that easy if financial diligence is taking place, which we will address in the next section.
4. There is no requirement to fill out IRS Form 8853 at tax time. However, this generally only applies if this is the only policy owned on the insured. If there are multiple policies, then chances are that Form 8853 will need to be completed. And some reimbursement policies have an optional feature where the policy owner can take limited cash benefits. If that feature is exercised, then the policy owner will still have to fill out Form 8853.

Cash Indemnity Benefits

1. The biggest advantage for most people is the flexibility of these policies. There are no restrictions from the insurance company on how LTC benefits are used. For example, alternative care services can be utilized without getting approval from the insurance company. During emergencies such as we saw with the pandemic, families could make quick decisions on changes in care needs – such as taking a parent out of a nursing home and providing family care – again with no need to get approval from the insurance company. It also means that 100% of the benefits can be used to pay less expensive unlicensed care providers or family members.
2. Once claims qualifications have been met, there is no monthly paperwork or proof of expenses to submit in order to receive LTC benefits. The full available monthly benefit (or amount requested if they wish to take less) is paid to the policy owner. This can be an easier process for people who wish to deal upfront with what is owed instead of waiting to see what is approved for reimbursement but still having to send a check for uncovered expenses.
3. Depending on the LTC benefit amount purchased, cash indemnity policies can pay a benefit that exceeds the cost of care. With traditional LTC policies and linked benefit policies, this can result in collecting more than one would from a reimbursement policy. That is because cash indemnity policies pay the full available LTC monthly benefit, not just the cost of care as reimbursement policies pay. For people who own smaller benefit amounts, this may not come into play, but for larger policies – a cash indemnity policy could pay out far more in the end than a reimbursement policy.
4. For people retiring overseas, it may be easier to collect cash indemnity benefits. Assuming the insurance company will pay LTC benefits when the insured is receiving care abroad (and many do not or may have limitations), cash indemnity models do not have restrictions on the type of care providers, so there is greater latitude as to how care and where care could be received.

DISADVANTAGES OF THE LTC BENEFIT MODELS

Reimbursement Benefits

1. If direct billing options (i.e., third party billing) are not available with the care provider, or the policy owner is not comfortable with such an arrangement, then the policy owner or someone representing them must file copies of bills and receipts each month in order to collect the LTC benefits.
2. Only expenses covered by the policy contract, up to the available benefit amount, will be reimbursed. Any other care expenses not covered under the policy will need to be paid for out of pocket. This applies whether direct billing is used, or the policy owner sends in the bills and receipts for reimbursement.
3. Because only actual expenses are reimbursed – this can affect the total amount collected from the policy.
   a. Traditional LTC policies - any unused LTC benefits at death are lost[1].
   b. Linked benefit policies – any unused benefits left in the second benefit pool (the extension of benefits) at death are lost[1].
   c. LTC riders on life insurance – this type of policy would not be affected since the full death benefit pays whether as LTC benefits, death benefits or a combination of both.

Cash Indemnity Benefits

1. When collecting cash indemnity benefits, IRS Form 8853 will need to be submitted. However, this is a once-a-year event and is quick and easy to do. Form 8853 is included with the standard version of tax preparation software, which will quickly help the taxpayer to insert the information needed.
2. Under some circumstances of paying informal caregivers or a family member, there may be tax withholding requirements and additional tax forms to fill out. However, such situations are not as common as portrayed. This will depend greatly on the circumstances, and it would be wise for the policy owner to involve their tax advisor as with all planning. We will address this further in the next section on myths.
3. Cash indemnity payments can exceed the cost of care, and if the policy owner is not good with money – they may spend it instead of saving for future care.

BUSTING THE MYTHS AND MISCONCEPTIONS

There are so many myths and misconception out there that is no wonder confusion abounds. And unfortunately, most myths center around indemnity policies. As I said in the beginning of this article, there is no one perfect LTC benefit model for each and every situation. Each individual or couple has their own unique circumstance to solve for, and what may be best for one individual or couple may not be the best for another. That said, we are going bust the myths one by one.

Myth #1 – "Cash indemnity (or indemnity of any kind) is taxable above the HIPAA per diem, and reimbursement benefits are not."

Neither statement is necessarily true. And a bit of explanation is required. First, we will address the IRS guidelines for tax free LTC benefits. *You may collect LTC benefits, cumulative of all policies owned on an insured, tax free, to the greater of: the HIPAA per diem in the year of claim, or actual qualifying LTC expenses incurred[2].*

Cash indemnity benefits (or other versions of indemnity) – The following would apply:

- If your LTC benefits are equal to or less than the HIPAA per diem, they are all tax free! You do not need to justify expenses.
- If your LTC expenses exceed HIPAA, and you receive an LTC benefit amount no more than the cost of your LTC expenses, the benefits are still tax free! (It is wise to store receipts with the copy of the tax return)
- If you receive LTC benefits exceeding the HIPAA per diem, and your expenses are less than you received in LTC benefits but more than HIPAA, then you would only be taxed on the difference between what you received and your cost of care.
- If you receive LTC benefits that exceed the HIPAA per diem, and your expenses are less than you received in LTC benefits and also less than the HIPAA per diem, then you would only be taxed on the difference between what you received and the HIPAA per diem amount.

The following is an example of how tax-free benefits work.

Example:

The HIPAA per diem is $420 per day in a 30-day month – which equals $12,600. LTC expenses for that month were $15,000. The LTC monthly benefit amount paid from the cash indemnity policy was $15,000. No tax is due. Why?

- Indemnity policies are tax free to the greater of the HIPAA per diem or LTC costs incurred. In this example, even though LTC benefits received exceeded HIPAA, they did not exceed the cost of care, therefore they are tax free.

However, if LTC expenses had only been $14,000 for the month, the policy owner either ask the insurance company to lower the monthly benefit amount from their policy to avoid taxation, or pay income tax on $1,000. Why only $1,000?

- Because they had LTC expenses to justify receiving $14,000 of the benefits tax free. Therefore, only the difference between the cost of care ($14,000) and the LTC benefit amount received ($15,000) is taxable.

Reimbursement benefits – The following would apply:

- If there is only one policy on an insured and it only pays reimbursement benefits, then the benefits will be tax free, no matter the amount. This is because only LTC expenses qualified under the contract are reimbursed, so benefits received naturally fall within IRS guidelines.
- If a person owns more than one reimbursement policy AND all policies coordinate LTC benefits (meaning each company only pays a pro-rata amount of the expenses and no more in total than actual expenses are reimbursed), then benefits are tax free.

But there are other things that could happen.

- If LTC benefits are being reimbursed from more than one policy and no coordination of benefits is occurring, even if all policies are reimbursement, then taxation would occur if the total amount reimbursed exceeds the IRS guidelines.
- If benefits are received from both a reimbursement and indemnity policy, then there will be no coordination of benefits. This could result in taxation if the total amount reimbursed from the reimbursement policy and received from the indemnity policy exceeds the IRS guidelines.

The reality – Very few policy owners will have benefits above HIPAA at time of claim, because most LTC policies are purchased with benefits equal to or less than the HIPAA per diem in the year they were sold! Because the HIPAA per diem generally rises each year in accordance with a formula tied to the CPI, policies that were issued with LTC benefits above the HIPAA per diem may not be above HIPAA at the time LTC benefits are needed, due to the continuous rise in the HIPAA per diem amount over time. Therefore, very few policy owners will ever have this as a concern.

Myth #2 – "Cash Indemnity benefits don't last as long, because the full amount is paid, even if it is more than expenses."

Cash Indemnity - the insurance company does not force the policy owner to take their full LTC benefit. The policy owner has the right to take less. When you consider that a reimbursement policy may not cover all expenses the insured incurs, having an indemninty policy with some control as to how much is taken in LTC benefits can help prevent out of pocket expenses.

Reimbursement – It pays what it pays. Depending on the type of care received, it may pay for all LTC expenses – or their could be out of pocket expenses.

The reality - For policies with smaller benefit pools, whether the policy is a reimbursement or a cash indeminty policy, it is likely that care expenses would exhaust the monthly LTC benefit – so this isn't an issue. For larger policies, yes, it could run out sooner if excess benefits are not properly managed and saved. But if the benefit model was chosen based on the desired type of care needs, then the chosen benefit model, whether cash indemntiy or reimbursement, should serve the insured nicely.

Myth #3 – "Cash indemnity policies are more expensive"

That depends on the product you are talking about. Let's break this down by product line

- Traditional LTC insurance - When comparing the price of an indemnity policy to a reimbursement policy, then this statement is likely true most of the time. That is because the benefit pool is 100% net amount at risk to the insurance company. Indemnity policies pay 100% of the benefit, while reimbursement policies pay less than the available benefit when actual LTC expenses are lower, making these policies less expensive most of the time.

- LTC Riders on Life Insurance – This normally is not true. The cost of the LTC rider on life insurance is a tiny portion of the premium – a charge that pays for the potential that the death benefit will be accelerated prior to death for LTC needs. The primary cost of the policy is the life insurance. Because of that, pricing competition between benefit models relies primarily on how aggressive an insurance company is when pricing the base life insurance policy. In addition, the entire death benefit of the policy is collected one way or the other, be it as LTC benefits, death benefits, or a combination of both. Therefore, neither reimbursement nor cash indemnity policies have a real advantage here.
- Linked Benefit Policies (Hybrid LTC) – This may or may not be true. A linked benefit policy is a combination of a LTC Rider on Life insurance and Extension of Benefits (equivalent to traditional LTC insurance). Since the first bucket of LTC benefits are essentially life insurance with an LTC rider, there is little to no advantage here. With larger policies, indemnity will generally pay out the first bucket faster, thus getting to the second bucket sooner, which increases the cost. However, with smaller policies, expenses will likely use up the entire benefit, thus there is no pricing advantage. While the second bucket is pure risk to the insurance company, it is the last benefit accessed, thus the risk to an indemnity based linked benefit policy is much lower than it would be with a traditional LTC policy. Therefore, in the overall picture, the timing of pricing the policies will provide a back-and-forth advantage.

The reality – Individuals and couples looking to buy LTC insurance may want to consider value over price. The least expensive policy may not bring the value they are looking for should an LTC claim occur. In addition, other features such as the elimination period and minimum guaranteed death benefit, will play a role in determining the net cost. Short claims may pay more when the policy has a 0-day or retroactive to 0-day elimination period. Longer claims may benefit from a more generous minimum guaranteed death benefit. The overall value one policy may provide over another may well justify a slightly larger premium cost.

Myth #4 – "Cash indemnity policies turn the policy owner or a family member into a bookkeeper, which takes time away from quality visits with parents (or the cared-for)"

The premise behind this myth is that because reimbursement policies will do direct billing, this results in no monthly bills for the policy owner or family member to pay - while indemnity policies "burden" family members with monthly bill paying and bookkeeping. In reality, both benefit models require attention to detail on a monthly basis if proper financial diligence is being done.

Reimbursement –
Owner directed reimbursement - If the policy owner chooses to handle bills themselves, then they pay the facility each month, submit bills and receipts each month to the insurance company, wait to see what is covered, and receive their reimbursement. Then they pay the bills that are not covered under the policy. Some families may be more comfortable with this process.

Direct reimbursement - Even if the policy owner chooses direct billing (and the care provider is willing), this does not eliminate the need to pay monthly bills or do their due diligence. There are usually expenses that are not covered by the reimbursement policy – especially when the insured receives care in a facility setting where non-covered expenses such as gift shop purchases, hairdresser/barber services, and meals for visiting family are added to the monthly bill. This will result in the need to personally pay for services each month not covered under the LTC policy. In addition, it is important that someone is doing a monthly check for double billing – comparing what the policy was directly billed and reimbursed for, compared to the bill that was paid for out of pocket and make sure the insured was not billed twice for any services.

Cash Indemnity – The policy owner receives a bill(s) from the care provider(s), looks it over for accuracy and pays it. It is possible that if there are multiple care providers, there may be a few bills to pay each month. But in the big picture, it is unlikely that the time it takes to pay those bills is any more than the time to properly monitor a reimbursement policy.

The reality – Helping a loved one manage their LTC experience is not a task free job – no matter which benefit model that monthly LTC benefits are coming from. Both plans merit monthly financial due diligence and reviewing and keeping copies of the bills and receipts for many reasons, which include but are not limited to:

- Reviewing bills to make sure services billed for were received
- LTC expenses paid out of pocket that exceed the amount of LTC benefits received could be tax deductible or eligible for HSA reimbursement.
- In the rare occurrence that LTC benefits received exceed the HIPAA per diem (which is rare), the saved records can be used to justify receiving the entire benefit amount tax free per the IRS guidelines.

Myth #5 – "Cash indemnity benefits are subject to elder financial abuse while reimbursement policies are far safer from this risk"

The reality - All insurance companies are required to watch for financial elder abuse. In addition, reimbursement benefits can be misappropriated by an "unscrupulous" relative or caregiver who has powers of attorney just as easily as any indemnity benefit. One could also argue that reimbursement policies are more subject to abuse by unscrupulous care providers who participate in direct billing with the insurance company, but then send duplicate bills to the insured.

This myth is unnecessary, an inappropriate scare tactic, and quite frankly of no help to people trying to make a decision on buying LTC coverage. This myth should be put to rest.

Myth #6 – "Cash indemnity turns the policy owner into an employer when paying unlicensed caregivers, with massive amounts of paperwork to do,"

This requires a more complex answer, since there are a variety of possibilities. Is it possible that the policy owner or insured's family member or representative could become an employer with paperwork and tax withholding to deal with? Sure, it is possible. But there are numerous instances where this simply will not happen, nor does it need to happen with proper planning and council from a legal or tax advisor. We will break down some of the possibilities below.

Non-employee situations

- Spouses providing care are not employees. If the insured's plan of care (required by regulation regardless of the benefit model) states informal care is appropriate, then the spouse can be that informal care provider. Any LTC benefits collected simply follow IRS guidelines as stated above. No one is employed, and no one is an employer.
- Your child under the age of 21 is not an employee.
- Any child under age 18 at any point during the year will not be considered an employee as long as caregiving is not their primary occupation. A student earning extra money by providing care is a typical example.
- Many unlicensed informal care providers are set up as a business entity. They bill the insured and pay taxes as a business owner. This arrangement would not cause the insured to be an employer.

Options for adult children providing care

For some families, their comfort level is having a family member provide care – which cash indemnity benefits allows for.

- Some tax advisors recommend rental agreements. This would apply when a parent moves in with an adult child. For example: mom simply pays rent to the daughter. Yes, the daughter (adult child) must pay tax on the rental income, but this avoids the paperwork required of being an employer and withholding taxes.
- Gifting is another possibility, though this should be done with council from a tax/legal advisor. Gifting does have a lookback for Medicaid purposes, though most people purchasing LTC coverage will not need to go on Medicaid. Depending on the situation of a particular individual, gifting may or may not be a solution to paying a family member.

When the insured/policy owner would be an employer

- If the insured is paying an unlicensed caregiver who is <u>not</u> set up as a business entity, but working simply as a contractor, then an employer/employee relationship will likely exist. In that case, any income paid in cash wages that exceed the annual limits provided by the IRS ($2600 or more in 2023) will be subject to withholding for Social Security and Medicare.

The reality - It is really a matter of whether the caregiver is an employee, or the cared-for (patient) is a client of some form of business entity providing LTC services. With thought and proper planning, the insured can receive quality care from a less expensive unlicensed caregiver without being subject to being an employer.

***<u>Challenge Question</u>* –**
If cash indemnity benefits are so problematic , why do some reimbursement companies offer an optional cash indemnity benefit?

Good question. In truth, both benefit payment models have their advantages and disadvantages, but neither benefit model is bad. It boils down to which benefit model will provide an individual or couple with the maximum benefit they need for the care they desire, and which model suits their preferred manner of financially managing the policy.

FINAL THOUGHTS

As I have mentioned before, no one benefit model or insurance company offers a policy that fits the needs of all individuals buying LTC coverage. Discussing care options and desires as described in the beginning of this article – the who, what and where of care – will help pinpoint the benefit model that will best fit an individual's needs when receiving LTC services.

Family care should be a choice, not a necessity. That is why LTC planning should be on everyone's list of priorities, and having dedicated funding to pay for LTC is so important. But it is also important to recognize that with some families and cultures, it is expected and planned for that family members will be part of the care strategy. Whether it is expected that those family members to be financially compensated is another question to consider. And yet, other families may want to avoid at all costs having to depend on family members for care.

LTC coverage helps protect the financial retirement plan of the individual or couple as well as family continuity among adult children. A comprehensive LTC plan should include a funding strategy, as well as instructions to loved ones on the type of care the individual would prefer. Taking steps now to put an LTC strategy in place can save time, money, and help keep family dynamics in a good place.

[1]There are traditional LTC policies that have optional return of premium riders for a substantial additional cost. They riders vary by product, so please consult the carrier . While the second benefit pool of a linked benefit policy does not pay any remaining benefits at death, most carrier do offer a residual death benefit. The amount varies greatly by carrier so please consult the insurance company.

[2]In the event that there are multiple policies with different owners, the insured – if they own any of the policies – receives first rights to any tax-free benefits. The remaining tax free and taxable amounts would be split pro-rata between the other policy owners. If the insured does not own any of the policies, all owners split the tax free and taxable benefits pro-rata. In addition, all owners must use the same reporting formula. Please consult a tax advisor for more information. Guidance can be found with Instructions for Filing Form 8853. The tax-free formula for LTC benefits can be found in IRS Publication 525.

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