Steve Leimberg's Financial Products Planning Email Newsletter - Archive Message #57

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From: **Steve Leimberg's Financial Products Planning Newsletter**

Subject: **Steven A. Fishman and Martin M. Shenkman: Long-Term Care Coverage in Irrevocable Trust Planning - Structural Risks, Planning Alternatives, and Practice Implications**

"Modern estate planning for high-net-worth individuals relies on integrated insurance solutions to address mortality risk, disability exposure, and long-term care contingencies. While life insurance has long been embedded within irrevocable trust structures, such as irrevocable life insurance trusts, to create liquidity and facilitate wealth transfer, other forms of coverage—particularly long-term care insurance—have not been incorporated with comparable rigor. This omission reflects a planning opportunity, especially in the context of nonreciprocal spousal lifetime access trusts."

Steven A. Fishman and Martin M. Shenkman provide members with commentary that examines how irrevocable trust design can affect long-term care planning, Medicaid eligibility, asset protection goals, and client access to care, as well as why practitioners must carefully balance protection, flexibility, liquidity, and insurance alternatives before transferring assets out of a client's reach.

Steven A. Fishman is an Estate and Business Planner with Planning Alliance as well as President of Norwood Financial Group, LLC., a member firm of the Planning Alliance network. He works with professionals, family business entities, and closely held business owners. He has established a solid concentration in working with CPAs, attorneys, and their clients. His practice is focused on advanced planning in the areas of estate and business planning, insurance planning, and risk mitigation. He emphasizes relationship-based planning over isolated transactional planning in order to facilitate inputs from clients, centers of influence, and other trusted advisors. Steven joined the firm in 2019. In 2000, he launched Norwood Financial Group, LLC. Prior to Planning Alliance, he was a member of Partner's Financial from 2002 to 2018, a national independent producer group. He has been helping clients in the financial services arena since 1983. Steven received his Bachelor of Science in Finance from Ithaca College in 1981. He is a member of the Association for Advanced Life Underwriting (AALU)

and is a long time and committed Board Member of the Jewish Community Foundation of Greater Metrowest NJ, Inc.

Martin M. Shenkman, CPA, MBA, JD, PFS, AEP (Distinguished) is author of more than 40 books and more than 1,400 articles on estate planning and related topics. He is a frequent lecturer for numerous trade, professional and other organizations. He is active in numerous charitable endeavors. He has practiced estate planning for 35+ years.[i]

Here is their commentary:

COMMENT:

The Expanding Role of Insurance in Advanced Wealth Planning

Modern estate planning for high-net-worth individuals relies on integrated insurance solutions to address mortality risk, disability exposure, and long-term care ("LTC") contingencies. While life insurance has long been embedded within irrevocable trust structures, such as irrevocable life insurance trusts ("ILITs"), to create liquidity and facilitate wealth transfer, other forms of coverage—particularly long-term care insurance—have not been incorporated with comparable rigor. This omission reflects a planning opportunity, especially in the context of nonreciprocal spousal lifetime access trusts ("SLATs").

Despite issues and risks of SLATs associated with the reciprocal trust doctrine and potential divorce, which can be addressed in the SLAT plan, SLATs remain a popular planning tool for married clients in a wide range of wealth levels from the mass affluent clients (yes, SLATs for asset protection planning, upstream basis planning and in non-grantor variants can all be valuable planning options for moderate wealth clients) to the UHNW client. LTC insurance has not received enough consideration as part of overall irrevocable trust planning. The limited use of LTC insurance in SLAT planning may also reflect the underlying structural tax tensions between the functional attributes of long-term care benefits and the legal architecture of irrevocable trusts. The bottom line, as discussed below, there can be an important role of LTC in a non-reciprocal SLAT overall plan, even if the coverage is ultimately determined to be held outside the SLATs.

A comprehensive planning framework must therefore evaluate not only the financial merits of coverage, but its compatibility with transfer tax objectives, creditor protection goals, and trust design. When analyzed through this lens, long-term care coverage presents unique benefits and challenges that frequently outweigh the perceived advantages of integrating ownership of such coverage into trust structures. The ownership decision is separate from the analysis of how LTC can bolster the estate plan itself.

Important to estate planning professionals advising clients on irrevocable trust plans, the mere process of the clients reviewing long term care coverage can serve to enhance client understanding of the planning process, the economic implications of the planning, and prove protective to the practitioners involved.

SLAT Insurance Planning Should Not Only Be About Life Insurance

Life insurance planning is common in the context of both SLAT planning (e.g., only one spouse creates a SLAT), and non-reciprocal SLATs, to address mortality risk. But life insurance is not the only type of insurance that may be helpful to consider. Despite the potential importance in filling financial gaps of these trust plans, coverage for disability and long-term care risks is sometimes overlooked in the planning analysis, even when the planning circumstances might warrant consideration. This omission could represent a significant financial gap, particularly given the magnitude of potential exposure and the behavioral responses it can create among clients. This may be particularly true when the wealth level of the clients is lower. UHNW clients likely do not need either LTC or disability coverage, moderate wealth clients are more likely to need the coverage. But even for UHNW clients, there can be benefit to exploring coverage even if it is rejected.

Psychological and Behavioral Drivers Supporting Long-Term Care Coverage

Even for clients with substantial wealth, long-term care planning is not solely a financial decision. The act of transferring a meaningful portion of wealth into irrevocable structures may create a perception of reduced liquidity or control, even when the economic reality suggests otherwise because of the access the trust plan affords, and because of the material wealth remaining in the clients' names outside trust solution.

More importantly, long-term care coverage serves a protective function not only for the insured spouse (or partner), but for the healthy spouse. The caregiving dynamic can impose substantial physical, emotional, and health-related burdens on the well spouse, potentially affecting longevity and quality of life. The well spouse may devote so much time, effort, and emotional capital to caring for the ill spouse that it adversely affects their well-being. If the long term care coverage is purchased, the funds to pay for professional care givers, independent of the obvious financial benefits, are a reminder to the well spouse that before the illness occurred both spouses agreed to use the coverage to provide assistance. That may emotionally empower the well spouse to better take care for themselves.[ii] Structuring LTC coverage to ensure that professional care resources are available can mitigate both emotional and financial risks, and it may aligns with broader family planning objectives.

These considerations may substantially strengthen the case for recommending long-term care coverage as part of a holistic planning process, even where clients have sufficient assets to self-insure.

Possible Structural Incompatibility Between Long-Term Care Benefits and Trust Design

Notwithstanding the merits of long-term care coverage as a standalone product, its integration into irrevocable trust structures, such as SLATs, may raise significant technical concerns.

A fundamental issue arises from the disconnect between the insured individual and the trust beneficiary structure. Where an irrevocable trust is created for the benefit of a spouse (or other parties), the grantor typically lacks beneficiary status. This is the case in a traditional SLAT structure and certainly in a typical dynastic trust for children or other heirs. Consequently, if the trust owns LTC insurance, the long-term care benefits payable to the trust cannot be readily accessed by the insured individual without additional structuring. And it may not even be feasible to do so altogether.

Example: Husband creates a SLAT for wife. Husband contributes $5 million of marketable securities and a Life Insurance policy with an LTC rider to the SLAT. A year later Husband falls ill and requires home health care. How can the LTC benefits be accessed? If the trustee files a claim the husband is not a beneficiary of the SLAT, so no distribution can be made to him. Theoretically, if the trust instrument permits the trustee may be able to loan funds to the husband for long term care costs but that is cumbersome at best and may undermine the estate plan. If the husband gifted or sold a life insurance policy to the SLAT with an LTC rider, does that suggest that there was an implied agreement that the trustee would somehow remit the LTC benefits to the husband/settlor? That would seem to support an attack on the husband having a retained interest in the LTC benefit, and perhaps undermine the plan by causing some portion or all of the trust to be included in the husband's estate. There have been commentators that have suggested that this is not the case.

Attempts to resolve this limitation on accessing LTC benefits often involve indirect mechanisms, such as trustee loans or discretionary distributions to the beneficiary spouse who could then funnel the funds directly or indirectly to the spouse who is covered by the LTC rider. These approaches introduce complexity and uncertainty, and may not function as intended in practice. In particular, LTC policies that require documentation of incurred health related expenses exacerbate these difficulties, as they impose administrative constraints that do not align cleanly with trust mechanics. It would seem that if the insured/settlor spouse has to provide proof of care costs to the trustee to provide to the insurance carrier, that could document and corroborate the retained interest.

Even where more flexible indemnity-style benefits are available, the fundamental issue may remain that the insured individual is attempting to derive benefit from a trust structure that does not recognize them as a beneficiary.

Another approach may be to create the SLAT in one of the approximately 22 states that permits self-settled trust and permit the grantor spouse which is insured to also be a beneficiary. If the plan had not, apart from the LTC coverage contemplated that structure the incremental cost and complexity, and incremental tax and creditor risk of a self-settled trust may make that approach unacceptable to the client.

Implied Agreement and Estate Inclusion Risk

The most significant concern is the potential existence of an implied agreement or retained benefit that could result in estate inclusion. Where a trust is structured in a manner that effectively contemplates the grantor's access to long-term care benefits, the arrangement may be viewed as the settlor retaining a prohibited retained interest.

This risk exists both in scenarios where an existing policy is transferred into a trust and where a trust acquires a policy directly (i.e., not as a gift or sale by the insured). While the former presents a more direct case for inclusion, the latter may still support an inference that the arrangement was designed to confer economic benefit on the grantor.

Such an inference could support arguments under traditional estate inclusion principles, including theories relating to retained enjoyment or control. In addition, creditor exposure may arise where access to trust benefits is effectively reserved for the grantor.

The risk is not eliminated through the use of self-settled trust structures such as a domestic asset protection trust (DAPT) created in a jurisdiction where that type of trust is permitted. Variations of a DAPT such as the hybrid DAPT or special power of appointment trust (SPAT) would seem to fare no better. Although such structures may permit distributions to the grantor under local law, the existence of a prearranged expectation of the settlor receiving the LTC benefit may still undermine the intended tax and asset protection outcomes.

Comparative Analysis: Optimal Asset Selection for Trust Funding

A critical planning distinction lies in the economic profile of long-term care coverage relative to other assets. Unlike life insurance, which may be designed to maximize a death benefit for the insured's family or other trust beneficiaries, long-term care coverage may function as a "wasting" asset, with value diminishing as care benefits are utilized.

From a transfer tax perspective, this characteristic reduces the desirability of placing such coverage within an irrevocable trust. Assets intended for trust funding are generally selected based on their potential for appreciation, leverage, or valuation discount opportunities. Long-term care coverage may not align with these objectives.

Accordingly, allocating exemption capacity to long-term care coverage may represent a suboptimal use of planning resources if there are more advantageous assets to use to fund the trust plan. Worse, the LTC coverage may support a creditor or IRS scrutiny on the viability of the trust plan.

Recommended Planning Structure: Separation of Functions

A more robust planning framework separates life insurance and long-term care coverage, both functionally and structurally.

Under this approach:

• Life insurance is owned within an irrevocable trust, such as an ILIT, SLAT, or other trust, to provide estate liquidity and facilitate wealth transfer objectives.

• Long-term care coverage is owned outside the trust, preserving direct access to benefits and avoiding inclusion risks. That does not mean that the decision to purchase LTC coverage is not integrally related to the overall trust plan, it should be. Just that it is owned outside the trust structure while supporting that trust plan.

This structure aligns the characteristics of each product with the appropriate ownership vehicle, minimizing legal and estate inclusion risks while preserving economic efficiency.

The approach is particularly compelling in cases involving blended families or multiple marriages, where preserving death benefit integrity may be critical. Utilizing long-term care riders within life insurance policies intended to benefit beneficiaries, e.g. a new spouse or children from a prior marriage, may risk depleting the very asset intended to satisfy spousal or familial expectations.

Limitations of Hybrid or Rider-Based Approaches

Although the LTC policy referred to above may in fact be a small life insurance policy with LTC features owned outside a trust, practitioners should review the various policy structures the client considers. Combining life insurance and long-term care benefits within a single policy may introduce additional complications. That is why a separate policy may be purchased for LTC needs and a different policy, likely much larger in terms of death benefit, purchased to address more pure life insurance objectives. Utilization of long-term care benefits typically

reduces the available death benefit, which may conflict with the objectives of estate liquidity planning. Moreover, embedding such features within a trust-owned policy does not resolve the underlying inclusion concerns and may exacerbate them by entangling otherwise straightforward life insurance structures with problematic LTC benefit features.

These factors may, in the view of some, weigh strongly against the use of long-term care riders in trust-owned policies, particularly where alternative structures are readily available.

Fraudulent Conveyance and Adequate Resource Considerations

The retention of long-term care coverage outside of trust structures may also serve an evidentiary function in demonstrating that a client has retained sufficient resources to meet foreseeable needs. This consideration is relevant in evaluating potential fraudulent conveyance exposure.

Because long-term care coverage is expected to be consumed over time, its inclusion within the client's retained asset base may support the reasonableness of the overall transfer strategy.

Also, the analysis done to determine if coverage is advisable, and how much and what type of coverage to use, may further backstop the deliberation that preceded transfers to the irrevocable trust.

Practice Risk Management and Advisory Coordination

A comprehensive planning process should incorporate multidisciplinary analysis, including input from financial and insurance specialists. Even where coverage is ultimately not implemented, documenting that such analysis has been conducted may mitigate exposure for the estate planner to professional liability claims based on the client not understanding the economic implications of the trust plan.

Providing clients with projections and scenario analyses illustrates potential financial risk exposures the plan might embody, and demonstrates that the planning process addressed a full spectrum of contingencies and possible solutions (e.g. life, disability and LTC coverage). This approach both enhances client understanding and strengthens the defensibility of the advisor's recommendations.

What About LTC Policies Currently Held inside Irrevocable Trusts

There has been discussion in the professions suggesting that the ownership of LTC coverage inside irrevocable trust structures was not only feasible, but even that it was advantageous. If the above analysis is convincing that the results may be otherwise, there may be a simple solution to the dilemma. Life insurance with LTC features is generally only held in grantor trusts. As such the settlor/insured

can swap out the policy for assets of equivalent value (or purchase the policy from the trust). That would solve the LTC retained interest issue. As part of this process evaluate the possible life insurance benefits and how they may be affected by this restructure. Determine if additional life insurance coverage might be advisable for the trust to purchase to continue the prior intended plan.

When swapping or purchasing life insurance from a grantor trust is it imperative that the value of the policy be confirmed. That analysis may have to consider values provided by the insurance carriers and perhaps secondary markets. It may be prudent to couple the swap or purchase of the life insurance with a valuation adjustment clause so that if the value is challenged the price paid or value swapped would be adjusted. Also, if feasible use cash for the swap or purchase to avoid any valuation issues on that half of the transaction.

Conclusion

The integration of long-term care coverage into irrevocable trust planning presents significant technical challenges that may undermine its effectiveness as a planning tool within such structures. While the need for long-term care coverage may be compelling, particularly from a behavioral and familial perspective, its structural incompatibility with traditional trust design suggest that while incorporating it into the planning, it might be preferable not to have the LTC coverage owned by the irrevocable trusts involved.

A disciplined separation of planning functions—placing life insurance within irrevocable trusts and maintaining long-term care coverage outside those structures— may provide a more coherent, defensible, and efficient solution. This approach preserves the integrity of estate planning objectives while ensuring that long-term care needs are addressed in a manner that remains accessible, flexible, and legally sound.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

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CITATIONS:

[i] Martin M. Shenkman is independent of and unaffiliated with Guardian, its affiliates or subsidiaries. His opinions are not necessarily those of Guardian or its subsidiaries and such opinions are subject to change without notice.

[ii] This idea was presented by Peter Strauss, Esq. a pre-eminent elder law attorney decades ago at a conference. It was and remains a testament to Peter's sensitivity to the human condition and a reminder how we all need to focus not just on technical aspects of planning, but the impact on the people involved. Planning Alliance is not an affiliate or subsidiary of PAS or Guardian. CA Insurance License #0B65894.

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