Some Annuities Offer a Way to Pay for Long-Term Care

Current estimates from AARP put the annual cost of a private nursing home room at a national average of $78,000. As older Americans are still struggling to reassemble their retirement plans from the worst economic downturn in 70 years, relatively few are considering the potentially most devastating threat to their plans: the spiraling cost of long-term care.

On January 1, some important provisions of the Pension Protection Act of 2006 went into effect to help pay for those costs. Individuals no longer have to pay federal income tax on the proceeds from an annuity if those proceeds are used to pay for long-term care coverage. That means that chronically ill or disabled people will no longer have to rely on their own private long-term care policies or Medicaid to pay for costs related to long-term care.

The change is spurring the creation of hybrid deferred annuity policies that also carry long-term care coverage. These products allow policyholders to use the proceeds for LTC coverage, for income or for both. The proceeds that went to pay for long-term care costs for the policyholder would not be subject to federal tax.

These long-term care annuities can generate tax-deferred gains, which works particularly well for those in high tax brackets who believe they will be in a lower bracket by the time they would need to draw on that coverage.

This option isn't for everyone and it's important to consult a financial expert and more important, a tax expert to decide if this alternative is for you. It's also important to compare the offerings of standard long-term care policies and these annuity/LTC hybrids since the hybrids are generally regarded to offer less LTC coverage in duration of benefits. Unless you have a significant amount to invest, these hybrid policies may not last beyond a year or two of benefits.

It's important to talk to both financial and tax experts before wading into this arena and to see how much coverage you can buy based on the size of the annuity you can afford.

Before studying these products more closely, it's important to look at the big picture of your finances and your expectations for care if you became temporarily or permanently disabled:

What resources do you have? This question goes beyond monetary issues. While caregiving puts a strain on family, it's important to consider whether family and friends are truly willing and able to help with your care, which can provide a considerable financial and emotional benefit.

Check your health history: People in good health purchasing long-term care insurance at the age of 55 usually get the most affordable deal in LTC insurance. But an individual's family health history and current health status are the real determinants of what your LTC insurance policy will cost – or if you'll qualify for coverage at all. Also, it's important to note that 40 percent of long-term care is provided to individuals between the ages of 19 and 65, so the need for care can strike at any time.

Are you a single female? Again, personal and family resources come into play here, but since women typically live longer than men – and they still earn less on average than men – women should take a heightened interest in providing for their long-term care safety net. Long-term care insurance might be a good solution given their other investments and their health history.

What types of services are covered? Over the course of time, long-term care policies have evolved to place more emphasis on home-based care or assisted living, since most people would choose to recover or live out their last days in a familiar environment. A basic LTC insurance policy pays for assistance with activities of daily living including eating, dressing, bathing, toileting, incontinence, and transferring (bed to chair, etc.). Each policy lists the types of services that are covered under nursing home care and under home health care. Homemaker services are generally covered and other services as listed in the policy.

What triggers the coverage? A qualified LTC policy won't go into effect until the covered individual can't perform two tasks of daily living for a specific period of time, typically 90 days, or when that person needs substantial supervision related to cognitive impairment. This is where you have to read the fine print since some policies are more restrictive than others. More affordable policies generally take longer to kick in. See if coverage for other physical ailments is available as part of the policy and what per-diem or monthly allowances are offered.

What if I never want to go to a nursing home? The idea is to cover every eventuality. The best-designed LTC policies will pay the same amount of benefit whether care is received in a long-term care facility, an assisted living facility, an adult day care center, or in the home. Some policies do offer reduced percentages for home health care versus nursing home care, but it's a better idea to keep full percentages on home health care benefits since most people would rather stay in their homes.

How good is the insurer? Do your homework on the financial health and track record of the insurer you choose, and that's particularly important if you're buying a hybrid policy.

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