

Is Your Client's "LTC Rider" Actually an LTC Rider?

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There's a common misunderstanding about living benefits provided by permanent life insurance riders. While some permanent plans are built primarily to provide fully guaranteed, robust LTC plans, others are primarily built for death benefit protection with living benefits added as an additional, secondary benefit. At first glance, the plans appear very similar but can be vastly different in terms of the benefits they provide, the expenses associated, and what the client can expect.

Generally speaking, living benefits for chronic care fall into two categories: (1) tax-qualified long-term care under IRC Section 7702B and (2) chronic illness accelerations under IRC Section 101(g). These benefits behave differently from a planning and tax perspective.

Tax-qualified LTC riders under IRC Section 7702B are structured as long-term care insurance, meaning they typically provide a defined pool of benefits, operate within LTC per diem rules, and are designed to primarily address long term care costs. Premiums attributable to the LTC portion may be tax-deductible in certain situations (generally if the LTC premium cost is separately identifiable and client uses an itemized deduction for medical expenses that exceed 7.5% of AGI).

Chronic illness riders under IRC Section 101(g), on the other hand, are generally an acceleration of the life insurance death benefit. The premiums are considered life insurance and generally do not offer a deductible premium.

While both structures are intended to be received income-tax free, the planning outcomes for the client can be very different, including whether benefits extend beyond the death benefit, how claims are calculated, and how predictable the monthly benefit is at the time of claim.

Here's a quick rundown (from most to least robust benefits):

Life Insurance with an LTC Rider with an Extension of Benefits ("Linked Benefit" or "Hybrid")

The most robust LTC designs offer contractual guarantees, including the premium amount, premium duration, LTC benefit pool, LTC inflation protection, return of premium options, and a minimum death benefit. Benefits under these tax qualified LTC riders are generally received income-tax free (under IRC Section 7702B, subject to IRS per diem limits), which can be an important distinction from chronic illness rider acceleration.

The amount available for LTC is "extended" well beyond the death benefit amount, providing a generous amount of coverage for chronic care needs. In most plan designs, the money spent from the LTC pool will reduce the death benefit dollar for dollar with a minimum death benefit (e.g. \$5,000 - \$15,000) payable regardless of the LTC claim amount. Depending on the insurer, benefits are paid on an indemnity (cash) or reimbursement basis, which can impact how the benefits are used at the time of claim.

These plans are intended for those whose primary planning objective is longevity protection with the death benefit being a secondary benefit. The leading LTC insurance products in the market generally fall into this category.

Quick note: Not all LTC plans with an LTC Rider and an extension of benefits are fully guaranteed. Some are reliant on non-guaranteed projections. Always carefully review the contractual guarantees provided in

the carrier illustration, including whether inflation protection benefits are guaranteed or dependent on policy performance.

Simple summary: LTC benefits are generally contractually guaranteed and the benefit pool extends well beyond the death benefit amount. The LTC benefits generally fall under IRC Section 7702B, are received income tax free, and the LTC premium may be deductible.

Life Insurance with an LTC Rider without an Extension of Benefits

Unlike the aforementioned rider, these plans will only accelerate the death benefit amount for qualified LTC claims and rarely have traditional inflation protection. Once the death benefit has been fully accelerated, no additional LTC benefits remain. Some of the products in this category have fewer contractual guarantees than plans with an extension of benefits and can be reliant on non-guaranteed projections for the policy to succeed. Depending on policy design and funding assumptions, changes to interest crediting, and expenses can impact performance and materially impact the duration and availability of LTC benefits. Benefits may be structured as indemnity (cash) or reimbursement. Because these plans are typically structured under IRS Section 7702B and the benefits are generally received income-tax free (subject to the IRS per diem limits).

Simple summary: LTC benefits are generally not contractually guaranteed for life, and the benefit pool is restricted to the death benefit amount. The LTC benefits generally fall under IRC Section 7702B, are received income tax free, and the LTC premium may be deductible.

Life Insurance with a Chronic Illness Rider (for an additional up-front premium)

Chronic Illness Riders (CIR) are generally structured under IRC Section 101(g), which governs chronic illness accelerations rather than tax-qualified long-term care insurance. They do not qualify as LTC under IRS guidelines and that disclaimer will be provided on nearly every page of the illustration.

In this category, for an additional, separate fee from the life insurance, this rider provides protection for chronic illness. The reason many people confuse CIRs for an LTC rider is that one qualifies for claim in a similar way by being unable to do two of six activities of daily living or a severe cognitive impairment. However, claim payments are typically limited to an accelerated a portion of the death benefit with no extension of benefits available once that amount has been exhausted.

The amount available for chronic care is generally limited to a fixed percentage of the death benefit, which sounds straight forward, but it can quickly become complicated. Many advisors assume that a rider providing 2% acceleration of the death benefit per month will provide a simple, straight-forward benefit (for example, a \$500,000 policy providing \$10,000 per month). In actuality, chronic illness riders often apply actuarial discounting and interest assumptions (like discounting a future value back to present value), or carrier-specific claim factors (age, policy duration, gender) at the time of acceleration, meaning the actual benefit received may be lower than a simple percentage calculation would suggest in the illustration.

In addition, these plans generally do not provide inflation protection, which is a key aspect of LTC insurance planning.

Simple summary: These plans are not true LTC Riders and fall under IRC Section 101(g). They provide an acceleration of the death benefit for an additional up-front cost. These plans generally offer fewer

contractual guarantees and the calculation for benefits can be murky. CIR premiums are not itemized and therefore generally not deductible.

Life Insurance with a Chronic Illness Rider (No up-front premium)

These plans generally do not charge a fee up front or embed the fee in the premium. Similar to the previous section, a percentage of the death benefit is accelerated for those who qualify up to a specified percentage and less a fee. These plans are typically structured under IRC Section 101(g), meaning they are not tax-qualified LTC insurance riders. The cost to exercise the rider can sometimes be substantial thus reducing the anticipated benefits, particularly with plans that do not underwrite for the rider. Many of these designs also calculate the benefit at claim using various discounting methods that are not fixed when the policy is purchased. In other words, the amount of the chronic care benefit is not predetermined. Between the cost to exercise the rider and the potential discounting, the actual benefit provided may be materially different than expected (a simple percentage of the death benefit).

These plans are generally purchased primarily for life insurance protection with a secondary benefit being the chronic illness protection. Those who purchase the plan primarily for the chronic care benefits (or because they could not qualify for LTC insurance) may not have their expectations met at the time of claim. In some cases, benefits may be reduced further based on age at claim, policy performance, or lien-style acceleration structures that adjust policy values rather than providing a traditional indemnity payment.

Simple summary: Governed under IRC Section 101(g), these plans provide an acceleration of the death benefit without an additional cost up front. These plans generally offer fewer contractual guarantees, the calculation for benefits can be murky, and the cost to exercise the rider can be substantial. Premiums are generally not deductible.

Conclusion:

With all things associated with insurance, it is important to understand the details of the plans, with particular regard to the contractual guarantees, tax classification, and how benefits are paid at the time of claim. Advisors should carefully evaluate whether coverage provides a separate LTC benefit pool or simply accelerates the death benefit, how inflation is applied, whether the benefits are paid as indemnity or reimbursement, and how factors such as interest assumptions, fees, and policy performance may impact the amount ultimately received by the client. Before incorporating LTC components into a financial plan, it is critical to understand the mechanics of how the rider works, not just how it is described in the illustration.

| | Life Insurance with LTC Rider and Extension of Benefits | Life Insurance with LTC Rider Without Extension of Benefits | Chronic Illness Rider with Up-Front Fee | Chronic Illness Rider with No Up-Front Fee |
|--|--|---|---|--|
| Accelerate a portion of death benefit for LTC Needs | Yes | Yes | Yes | Yes |
| Qualify for claim by 2/6 ADLs or severe cognitive impairment | Yes | Yes | Yes | Yes |
| Benefits extend beyond death benefit | Yes | No | No | No |
| Premium amount and duration fixed | Generally, yes | Generally, no | Generally, no | Generally, no |
| Contractual inflation protection | Yes (Optional) | Generally, no | No | No |
| Portion may be eligible for deduction (7702B) | Yes | Yes | No | No |
| Predictable Benefit Structure | Yes | Generally, yes | Generally, no | No |
| Policy has lifetime no-lapse guarantee | Generally, yes | Generally, no | Generally, no | No |
| | <small>This comparison reflects common structural characteristics observed across general market designs and is intended for educational purposes only. Specific product features, guarantees, underwriting requirements, and rider availability may vary by carrier and policy design. Advisors should review carrier illustrations and contract language carefully before making planning assumptions.</small> | | | |

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