Long-Term Care Insurance Future Questionable

The future of long-term care insurance is uncertain and the viability of the market is in question, according to a new report by Moody's Investors Service.

Limited claims experience, long policy horizons, rising premiums and extreme market consolidation are all contributing to the indefinite outlook, writes Laura Bazer, Moody's vice president and author of the report, "Long-Term Care Insurance: Sector Profile."

"Key credit considerations for the sector are the relative newness of long-term care insurance and the long-tailed and complex product structure, which make it difficult to price the product profitably and to reserve for," Bazer said.

Early policies offered too-generous benefits in light of what turned out to be higher utilization and lower rates of lapsed policies than actuaries had forecast. Lately insurers have been increasing reserves, which has resulted in losses for some over the past two years and may not fix the problem.

"While recent hefty reserve and rate increases could improve the profitability of legacy blocks, or at least stem losses," Bazer said, "persistent low interest rates and anti-selection could confound the remediation process."

The response of some insurers has been to retreat from long-term care business, while those that remain are raising rates and cutting benefits. But Bazer said potential buyers may resist these changes, and regulators may block or limit new rate increases on a constituency like senior citizens living on fixed incomes.

Moody's notes that there is now only one major player, Genworth, and it wrote 38 percent of the individual long-term care insurance premium in 2011. With fewer sellers, sales could fall, calling into question the viability of the entire market, according to Moody's.

For an *Insurance Journal* article on the report titled "Is Long-Term Care Insurance Dying?", click here.

Federal Court Rules That Gay Widow Is Entitled to Estate Tax Refund

Finding that the Defense of Marriage Act's (DOMA's) denial of equal benefits to same-sex couples violates the Equal Protection Clause of the Fifth Amendment, a federal court judge has awarded the surviving spouse of a lesbian couple reimbursement for the tax bill she paid on her wife's estate.

Edith Windsor and Thea Spyer became engaged in 1967 and were married in Canada in 2007, although they lived in New York City. Ordinarily, spouses can leave any amount of property to their spouses free of federal estate tax. But when Ms. Spyer died in 2009, Ms. Windsor, now 82, had to pay Ms Spyer's estate tax bill because of DOMA, a 1996 law that denies federal recognition of gay marriages.

Although New York State considered the couple married, the federal government did not and taxed Ms. Syper's estate as though the two were not married. Ms. Windsor sued the U.S. government seeking to have DOMA declared unconstitutional and asking for a refund of the more than $350,000 in estate taxes she was forced to pay.

Federal court judge Barbara Jones from the U.S. District Court for the Southern District of New York ruled that there was no rational basis for DOMA's prohibition on recognizing same-sex marriages. Jones stated that it was unclear how DOMA preserves traditional marriage, which is one of the stated purposes of the law. As ElderLawAnswers reported last year, President Obama decided to stop defending DOMA, so members of Congress formed an advisory group to defend the law. This is the fifth case to strike down DOMA.

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Should You Do It Yourself?

LegalZoom™ advertises itself as a cheaper alternative to an attorney. Intuit, through its "Quicken WillMaker™", and other do-it-yourself programs, entice people to forgo professional advice, assuring them that the documents they create will be "just as good as one created by an attorney."

These programs and web sites are popular with lawyers, too! Why? Because they make more work for lawyers in the future.

Recently, *Consumer Reports* magazine recently evaluated LegalZoom, Nolo, and Rocket Lawyer in an article "Legal DIY sites no match for a Pro" (September 2012, p. 13.) The editors concluded that unless your needs are very simple, the will writing products of these companies not only are unlikely to meet your needs, but can even lead to unintended results. Among other issues, too often the documents produced are not properly tailored to individual jurisdictions (states). As stated in the article, "Many consumers are better off consulting a lawyer."

Laws are not static. They constantly change because of new case law and statutes. And lawyers keep up with these changes in order to best advise their clients. That's why these online legal sites issue significant disclaimers. For example, on the top left-hand corner of its estate planning questionnaire, LegalZoom reveals that 80 percent of people who fill in blank forms to create legal documents do so incorrectly. Despite this disclaimer, LegalZoom tries to reassure its customers that professionals are there to help; that customers can have "peace of mind" knowing that LegalZoom professionals will customize their will based on their legal decisions.

The hard fact is that people who use do-it-yourself estate planning kits end up with a false sense of security. They create documents that they believe will address their estate planning needs. But with estate planning documents, they are unlikely to discover their mistakes.

Why? Because the mistakes will not become evident until after they become incapacitated or die. And the people who will be left to deal with the mistakes are usually the people the documents were supposed to protect.

Attorneys don't simply fill in forms. Rather, we use the knowledge we have acquired during our many years of schooling and practice to advise you on the best way to protect your family, and preserve and distribute your assets in the manner you choose. And yes, that has a price.

Judge Orders Refund to Estate That Paid Tax Before Madoff Con Was Revealed

When New Jersey resident Theodore Warshaw died in 2006, his estate was valued at more than $1.8 million. Because in New Jersey any amounts in an estate above $675,000 are subject to estate tax, Mr. Warshaw's executors paid $88,677 to the state.

The bulk of Mr. Warshaw's assets were held in an IRA, and when he died the IRA went to a trust to benefit his widow. The IRA assets were allegedly being invested in stocks, bonds and other financial instruments by Bernard L. Madoff Securities, LLC. Mr. Madoff's company reported that at the time of Mr. Warshaw's death the value of the IRA was more than $1.4 million.

In December 2008, Mr. Madoff was arrested and it was revealed that Mr. Warshaw was among the victims of the largest Ponzi scheme in U.S. history. The money in Mr. Warshaw's IRA was not being invested but instead had been used to pay other "investors." The IRA's value was not $1.4 million but $0.

Learning this, Mr. Warshaw's estate requested a refund of the $88,677 estate tax it had paid New Jersey. The estate argued that the IRA actually had no value at the time of Mr. Warshaw's death and that therefore his taxable estate was well below the state's $675,000 threshold. New Jersey's Division of Taxation denied the requested refund.

Both sides asked the Tax Court of New Jersey to rule in their favor without a trial. In its argument to the court, the state Division of Taxation cited a 1929 U.S. Supreme Court holding that the value of assets in a taxable estate cannot be determined by events after the date of a death. *Ithaca Trust Co. v. United States*, 279 U.S. 151.

On June 28, 2012, the Tax Court of New Jersey ruled that the Division owes Mr. Washaw's estate the refund. The court wrote that despite the 1929 Supreme Court ruling, "subsequent events may be considered to establish evidence of fair market value as it existed on the date of death." The court held that the discovery of the Madoff Ponzi scheme was relevant to the determination of the IRA's value at the time of Mr. Warshaw's death, and that the IRA was in fact worthless at that time.

To read the tax court's decision in the case, *Estate of Warshaw v. Director, Division of Taxation*, click here.

Should You Give It Away?

For wealthy individuals and couples, gifting has always been an important part of estate planning. And now that the gift tax exemption stands at $5 million (5.12 million adjusted for inflation in 2012) and the top gift tax rate is 35%, the tax environment is especially favorable for making large gifts. Gifts of up to $5.12 million ($10.24 million for couples) in 2012 incur no gift tax. BUT – these levels are scheduled to expire after 2012, with the exemption automatically shrinking to $1 million and the top tax rate jumping to 55% on January 1. So – should you take advantage now? If you do, are there any pitfalls? .

1. If you think Congress will act before next January 1 to make the $5 million exemption and 35% tax rate permanent, there's no pressure to act (and I've got a bridge I'd like to sell you).
2. On the other hand, if you expect Congress to allow

the estate tax to revert to 2001 levels – a $1M exemption and 55% top tax rate – you should seriously consider a gifting strategy – but you should be aware of a potential pitfalls.

First, the advantages. If you can afford to give up some or all of the benefit of the gifted property, it will remove from your estate all of the appreciation on and income from the property and avoid state estate taxes in states, such as Maryland, where there is no state gift tax.

Second, the pitfalls. Your donees will loss the benefit of the "step up" capital gains basis (although this will not be a problem if the asset already has a high basis), and gifts will still be included in your federal taxable estate and subject to the unlikely, but possible "clawback" tax, a scenario in which you might lose the benefit of the $5.12 million exemption.

To understand the "clawback" issue you should know how the estate tax actually is calculated (optional reading for the mascohistic):

Example 1. Assume a man is unmarried and owns assets worth $6 million, and makes a gift of $5 million in 2012, fully shielded by his $5 million exemption. He then dies, also in 2012, owning the remaining $1 million. When the trust or estate attorney prepares his federal estate tax return, the 2012 taxable gift of $5 million must be added back into the taxable estate at the date-of-gift value for purposes of calculating the estate tax amount. (Yes, it doesn't make sense. Write your Congressperson.) Thus the full $6 million would be included in the man's taxable federal estate, but would be offset by full use of his $5 million estate tax exemption[1]. This is done so that the remaining $1 million is "bumped" into a higher estate bracket, if there are higher brackets at the time of death. As long as the estate tax exemption available at death ($5 million in this example) is at least the same as the gift tax exemption used during life (also $5 million in this example), however, only the $1 million would be taxed.

<u>In this example, the only advantage to making the gift is that any future appreciation in the gifted asset's value is shielded from gift and estate taxes</u>, although there may be a capital gains income tax disadvantage because of loss of the "stepped up" basis to the donee of the gift.

Example 2. Now assume the gift and estate tax exemptions are $5 million in 2012, as in Example 1. Also assume future legislation establishes the exemption at $3.5 million after 2012, keeping the estate tax rate at 35% (a legitimate possibility if Congress finally gets its act together next year). Assume you own $6 million and in 2012 you gift $5 million to your adult children, fully shielded by your 2012 exemption. You die in 2013, owning the remaining $1 million.

Following the methodology described above in Example 1, to calculate your estate tax, you must include the gifted $5 million in your estate tax calculation, and then make full use of your estate tax exemption, which we have assumed to have decreased to $3.5 million. The result is to expose to the 35% estate tax not only your remaining $1 million, but also another $1.5 million (i.e., the decrease in exemption from $5 million to $3.5 million). The result could be an estate tax of $875,000 on an estate of $1 million. If the estate tax rate in 2013 is assumed to be 45%, the result could be an estate tax of $1,125,000 on an estate of $1 million – and Internal Revenue Service might try to collect $125,000 from the gift recipients!

This result is the "recapture problem" or "Clawback." Important – despite the Clawback, making the gift does NOT incur any additional tax. The estate ultimately receives just the benefit of the applicable exclusion amount at the individual's death if the Clawback applies. But liquidity certainly is an issue in this example – how will the estate tax will get paid, and which beneficiaries will bear the cost

Will Clawback happen?

Probably not, at least according to most tax experts, who contend that the Clawback interpretation is flawed. Many point to the obvious public policy concerns raised by such a tax – it obviously is unfair for taxpayers to make gifts in reliance on the current tax law and later be subject to tax because those laws change, and it is "likely not what Congress intended."[2]

But if Clawback happens . . .

If Clawback happens, the donor's estate still is likely to have benefited from the gifts made in 2012. The Clawback would be at the amount of the taxable gift, not the current value of the property given away. Therefore, the appreciation on the property given will not be taxed.[3] If the gift had not been made, the amount of the gift plus appreciation would be subject to tax. In a large estate, this can be significant.

In summary . . .

On balance, taking advantage of a $5 million exclusion that likely will disappear in 2013 is a great opportunity, and it is recommended for large estates with high basis assets that are likely to substantially appreciate. But – as always, a cost-benefit analysis should be made of the risk and timing of the gift, and the loss of control in the assets.

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[1]Technically it's not an exemption, but a credit equivalent.

However, it is more understandable to refer to it as an exemption.

[2]Am. Bar Ass’n, Estate and Gift Tax Comm., *Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010 27 (2011)*

[3]But this must be balanced against the loss of the “stepped up” basis of the assets that would be available if the assets passed at death.