Securely Covering Long-Term Care Premiums and Costs

One of the challenges of retirement is, should I need it, how will I pay for Long-Term Care (LTC) premiums and costs? Many people mistakenly believe that Medicare will pay for the cost. While it will pay for rehabilitative care, it does not pay for the classically defined long-term care. That said, how might you start to pay or think about paying for LTC?

Many people might assume that they would simply take money out of their 401(k) or IRA account and pay that way. Well, of course, that will mean that you will have to pay additional taxes. Yet one of the big issues with any type of insurance is insurability. The older we get, the more often we have various illnesses that might make us uninsurable by insurance carriers for LTC.

The SECURE 2.0 Act Opportunity

Being able to be insured (insurability) should always be a concern. Waiting until later to buy it might mean that your health conditions have changed and that may increase your premiums or making you completely uninsurable. To increase the chance of you being insurable for long-term care is to have you start paying before you retire.

The Setting Every Community Up for Retirement Enhancement 2.0 Act aka SECURE 2.0 Act provides an opportunity for you to pay for LTC premiums through taking distributions from your 401(k), 403(b), 457, TSP, and IRA accounts. This idea seems to be best suited for those who are between the ages of 50 and 60. This allows you to avoid the 10% penalty for making withdrawals before age 59 1/2. You still must pay taxes on pre-tax withdrawals.

When you turn 50+ you're able to make catch-up contributions to your 401(k) and IRA accounts. In 2023, the catch-up contribution is $7500. Imagine that you're able to withdraw $2,500, avoid the 10% penalty and only pay the taxes on the withdrawal. If you are in the 24% marginal federal tax rate, your withdrawal excluding state taxes would net about $2,000. You could then use that $2,000 to pay for LTC premium. I recently got a quote for a couple who are in their 50s. The premium they were quoted by one of the carriers was about $2,000 per person. But it gets even better.

IRS Deductibility of Long-Term Care Premiums

Were you aware that there was a deduction available for LTC premiums? Up to certain limits, the IRS allows for deductions of LTC premiums., In tax year 2023, if you are between the ages of 41 to 50 the limit is $850, 51 to 60 $1690, 61 to 70 $4,510, and 71+ $5,640. This medical expense deduction has a threshold of 7.5% of adjusted gross income. This is a per-person limit, not a single person, so a couple between age 51 to 60 could deduct $3,380. That goes up significantly once one partner reaches 61 and now the amount rises to $4,510. From a tax planning perspective, this would be great to know that expenses today, that may be considered high, will get some tax breaks for your treatment in future years. Why is the government offering this? Medicaid is the number one provider of LTC in America. Unfortunately, Medicaid means that your assets will be liquidated to pay for your LTC. I've personally seen it happen with family members. Always consult a tax professional.

Battling the emotion of not wanting long-term care

For many of us the challenge of LTC is that we simply don't want to ever need it. We don't want it. And we certainly don't want to pay for (even though the longer we wait, the higher the premiums will be). However, with costs skyrocketing, most people won't have enough assets to be able to cover the cost. If you add thoughts of passing on assets to heirs, that may get knocked out with a LTC event. If you have a spouse, this can make things even worse financially.

Paying for LTC sooner, rather than later, can help lock in insurability today, which is not guaranteed in the future. When planning for LTC, like most things financial, the path is likely not going to be straightforward. One needs to consider how much money they need to continue funding there, 401(k), 403(b), 457, TSP, and other assets. Another wrinkle in all of this is whether you have a Health Savings Account (HSA).

HSAs, if you're investing them, benefit from not touching your money for a while. This option is triple tax-free (no income tax, no capital gains taxes on growth and no taxes when used for health-related expenses) and you can pay for LTC premiums out of the HSA as well. I believe it's worth considering holding off on using your HSA until you are retired, so that it can benefit from a longer period of tax-free growth, rather than using it to pay for current expenses. You could also use it to pay for Medicare premiums and other health related costs.

The Secure Act 2.0 provides a unique planning opportunity. I believe it's worth looking at to see if a long-term care plan makes sense for you.