

## Long-Term Care Insurance



# Qualified LTC Insurance Federal Taxation

Metropolitan Life Insurance Company • New York, NY 10166 •

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## TQ LTCI Policy Benefits - Taxation

- TQ LTCI benefits received on a reimbursement basis are generally tax free
- TQ LTCI benefits received on a per diem (indemnity/cash) basis in excess of actual QLTC expenses incurred and/or annual IRC limit, less reimbursements from all sources including Medicare, may be taxable
- In 2006 the annual IRC limit is \$250 per day

Source: IRC Sec. 7702B(a)(2)(d)(2), 104(a)(3) and 105(b)



## TQ LTCI Policy Benefits - Taxation - Example

- 2006 IRC per diem limit = \$250 a day
- Value with Indemnity Rider Policy with a DBA of \$260
- QLTC expenses incurred = \$200
- Excess payment received = \$60
- Taxable Income = \$10 (\$260 - \$250)

Taxable income equals policy benefit payment minus the greater of the per diem limit or QLTC expenses incurred (assuming no other reimbursements received)



## TQ LTCI - Individual Tax Deduction

- Medical Expense Deduction
- 1040 Schedule A (individual must itemize deductions)
- The lesser of premiums paid for the year or TQ LTCI "eligible" premium (see chart) plus other unreimbursed medical expenses must exceed 7.5% of Adjusted Gross Income

Source: IRC Sec. 213(d)(1)(D) and 213(a)



## TQ "Eligible" LTCL Premium - 2006

<u>AGE</u>	<u>2006 Eligible Premium</u>
40 or less	\$ 280
41-50	\$ 530
51-60	\$1,060
61-70	\$2,830
70 and over	\$3,530



## Individual Deduction - Example

- John, age 55, has a TQ LTCI policy
- 2006 Tax Year
  - Annual TQ LTCI Premium = \$2,600
  - Adjusted Gross Income = \$70,000
  - Other unreimbursed Medical Expenses = \$6,000
  - 2006 TQ Maximum "Eligible" LTCI Premium = \$1,060
  - $\$70,000 \times 7.5\% = \$5,250$
  - $\$6,000 + \$1,060^* = \$7,060 - \$5,250 = \$1,810$
  - \$1,810 Total Medical Expense Deduction

\*Lesser of premiums paid or TQ eligible LTCI premium for year 6



## Individual Deduction - Example

- John at age 65
- 2006 Tax Year
  - Annual TQ LTCI Premium = \$2,600
  - Adjusted Gross Income = \$70,000
  - Other unreimbursed Medical Expenses = \$6,000
  - 2006 TQ Maximum "Eligible" LTCI Premium = \$2,830
  - $\$70,000 \times 7.5\% = \$5,250$
  - $\$6,000 + \$2,600^* = \$8,600 - \$5,250 = \$3,350$
  - \$3,350 Total Medical Expense Deduction

\*Lesser of premiums paid or eligible premium for year



## Individual Deduction - Example

- Jane age 65
- 2006 Tax Year
  - Annual TQ LTCI Premium = \$2,600
  - Adjusted Gross Income = \$70,000
  - Other unreimbursed Medical Expenses = \$1,000
  - 2006 TQ Maximum "Eligible" LTCI Premium = \$2,830
  - $\$70,000 \times 7.5\% = \$5,250$
  - $\$1,000 + \$2,600^* = \$3,600 - \$5,250 = (\$1,650) \$0.00$  Total Medical Expense Deduction

\*Lesser of premiums paid or TQ eligible LTCI premium for year





## C-Corporation

- Corporation pays employee's (including shareholder employee's) and their spouse's/dependent's TQ LTCI premium
- 100% of TQ LTCI premium paid can be tax deductible as a business expense if reasonable compensation
- Employer can pay premiums on a selective basis - only provide TQ LTCI to select group of key employees, provided there is a business reason for providing coverage to select group if it is not effectively a dividend to a corporate stockholder and it is pursuant to an employee long-term care benefit plan

Source: IRC Sec. 7702(a)(3) Note: It is possible that provisions of the IRC other than section 7702(B) may, under certain circumstances, limit the employer's deduction for accident and health premiums



## C Corporation - Continued

- No income tax to employee for TQ LTCI premiums paid by employer pursuant to an employee long-term care benefit plan
- TQ LTCI Benefits received are generally tax free, except if per diem is received in excess of QLTCI expenses incurred and/or IRC annual maximum, less reimbursements from all sources including Medicare and other insurance

Source: IRC Sec. 106(a) and 7702B(a)(3)



## Self-Employed

- **Self-Employed includes:**
  - Sole Proprietor
  - Partner in Partnership (including LLC treated as Partnerships for tax purposes)
  - S Corporation Shareholder owning more than 2% of corporation (including PC & PSC treated as an S- Corporation for tax purposes)

**Note:**     LLC - Limited Liability Corporation  
              PC - Professional Corporation  
              PSC - Personal Service Corporation



## Sole Proprietors

- **Medical Insurance Premium Deduction**
  - 100% of TQ LTCI “eligible” premium paid for sole proprietor and his/her spouse/dependents
  - 100% of TQ LTCI “total” premium paid for employees and their spouse/dependents
- **Generally no income tax to sole proprietor or employees for premiums paid by business**

**Source: IRC Sec. 162(l)(1)(B)**



## Sole Proprietor - Continued

- TQ LTCI Benefits received are generally tax free, except if per diem received is in excess of greater of QLTCI expenses incurred for the period and/or IRC per diem limit, less reimbursement from all sources including Medicare
- No deduction allowed on coverage for the owner, spouse or dependents if the owner is eligible to participate in any other employer subsidized (wholly or partially paid by an employer) plan which includes coverage for QLTC services including that of a spouse's employer and other insurance

Source: 106(a) and 162(l)(2)(B)



## Sole Proprietor - Example

- James age 51 self-employed plumber has a TQ LTCI policy
- Annual TQ LTCI premium = \$1,700.
- 2006 "eligible" premium = \$1,060
- $\$1,060^* \times 100\% = \$1,060$  deductible

\*Lesser of premiums paid or TQ eligible LTCI premium for year



## Partnerships including LLC

- 100% Tax Deduction to Partnership (business) for TQ LTCI premiums paid on behalf of partners and/or employees and their spouses/dependents
- TQ LTCI premium paid on behalf of partner(s) and his/her spouse/dependents is taxable income to partner(s)
- Partner with earnings from services rendered can take same deduction as sole proprietor on his/her tax return

Source: IRC Sec. 162(l)(1)(B) and 213(d)(10), 61, 707(c)



## Partnerships - Continued

- **TQ LTCI Benefits received are generally tax free, except if per diem received is in excess of QLTCI expenses incurred and/or IRC annual maximum**
- **Same employee selective basis rule applies as C-Corporation**

**Source: 106(a) and 162(1)(2)(B)**





## Partnership - Example

- Mary, age 45 and Joan, age 51 are partners
- TQ LTCI Premiums: Mary = \$1,600  
Joan = \$2,500  
Total = \$4,100
- Partnership (business) tax deduction = \$4,100
- Income reported to each partner equal to premium paid by partnership



## Partners 2006 Tax Deduction - Example

- **Mary, age 45**
  - TQ LTCI premium = \$1,600
  - 2006 "Eligible" premium = \$530
  - $\$530^* \times 100\% = \text{Tax Deduction}$
- **Joan, age 51**
  - TQ LTCI premium = \$2,500
  - 2006 "Eligible" premium = \$1,060
  - $\$1,060^* \times 100\% = \text{Tax Deduction}$

**\*Lesser of premiums paid or eligible premium for year**



## More than 2% Owners of Subchapter S - Corporation

- 2% or more owners treated the same as partners (including PC & PSC organized as S-Corporations)
- 100% tax deduction for the entity for TQ LTCI premiums paid on behalf of employee's (including shareholder employee's) and their spouse's/dependent's

Source: IRC Sec. 162(l)(1), 213(d) and 162(l)(2)(C), 162(1)(5)



## More than 2% Owners of Subchapter S - Corporation (continued)

- 100% of “eligible” premium tax deduction for premiums paid for 2% or more owner(s) and his/her spouse/dependents on their individual tax return
- No income tax to employees on TQ LTCL premium paid by business



## 2% or more Owners of Subchapter S - Corporation (continued)

- TQ LTCL premium paid on behalf of 2% or more owner(s) his/her spouse/dependents is taxable income to owner(s)
- TQ LTCL benefits received are generally tax free, except if per diem is received in excess of QLTCI expenses incurred and/or IRC annual maximum
- Same employee selective basis rule available as C-Corporation

Source: IRC Sec. 61



## Subchapter S - Example

- Bob, age 68 and Sue, age 65, a married couple own a small business (both own more than 2% of stock)
- The business purchases TQ LTCI for both of them
- TQ LTCI Premiums:      Bob = \$5,800  
   Sue = \$4,300

**2006 Business Entity Tax Deduction Total \$10,100**



## Subchapter S - Example

- 2006 "Eligible" premium Bob and Sue = \$2,830 each
- 2006 Tax deduction calculation
  - Total combined 2006 "eligible" Premium = \$5,660
  - $\$5,660 \times 100\% = \$5,660$  - 2006 Tax Deduction
  - Bob and Sue had to include the full \$10,100 in premium paid on their behalf in income, but they get to deduct \$5,660 on their personal income tax return



## LTCI Business Tax Benefit Summary

	<b>C-Corp.</b>	<b>S-Corp.</b>	<b>Partnerships</b>	<b>Sole Prop.</b>
<b>Business Tax Deduction</b>	100% of total premiums paid	100% of total premiums paid	100% of total premiums paid	100% of total premiums paid for employees, employees spouses & dependents
<b>Personal Tax Benefit to Owners</b>	None	2% or more owners can deduct 100% of "eligible" premiums paid for themselves, their spouses & dependents	Partners can deduct 100% of "eligible" premium paid for themselves, their spouses & dependents	The Owner can deduct 100% of "eligible" premium paid for themselves, their spouse & dependents
<b>Income Tax to Employee</b>	Generally None	Generally None	Generally None	Generally None
<b>Income Tax to Owners</b>	Generally None	Amount of Premiums paid on their behalf	Amount of Premiums paid on their behalf	Generally None





## Q & A

- Q. What are the tax consequences if a C-Corporation pays the LTCI premium for a non-employee Board of Director member?
- A. The premium is probably deductible to the Corporation as a fee paid to the Director. The premium to the Director would represent income. The Director should be able to treat the premium as a deduction subject to the rules applicable to other individual sole proprietors.



## Q & A

- Q. What is the Tax Treatment of Premiums for Non-Qualified LTCL Policies?
- A. The Internal Revenue Code (IRC) does not specifically address the income taxation of premiums paid or benefits received from Non-Qualified LTCL. Since Congress has enacted favorable legislation for TQ LTCL it is generally interpreted that this is an indication that Non-Qualified LTCL will **not** receive the same favorable tax treatment



## Q & A

- Q. Can a Tax-Exempt Organization (501(c)) pay for their employees and their spouses/dependents TQ LTCI premium?
- A. Yes, however, there would only be a tax deduction to the extent the Organization has taxable income, i. e., unrelated business income and the payments are directly connected to such income.



## Q & A

- Q. Can an employer pay the TQ LTCI premium for an employee's domestic partner and receive a tax deduction?
- A. Only, if the domestic partner can qualify as a dependent under IRC 152.



## Q & A

- Q. If the domestic partner is not a dependent of an employee and the employer pays the domestic partner's TQ LTCI premium what are the tax consequences?
- A. The premium would be included in the employee's gross income and the employer would get a tax deduction for wages paid.



## Q & A

- Q. What is a Health Spending Account (HSA)?
- A. An HSA is a trust created or organized in the U.S. to pay for qualified medical expenses of the account holder. An HSA is available only to an employer or individual who participates in a high deductible medical plan (as defined in IRC Section 223(c)(2)). Individual contributions to the Account are tax deductible and payments from the account for qualified medical expenses are not taxable. Please note that this is a very brief summary of complex rules that govern HSA's.



## Q & A

- Q. Can TQ LTCI Premiums be paid from a Flexible Spending Account (FSA)?
- A. No, FSA amounts should not be used to pay for LTCI. LTCI premiums are not a “qualified benefit” under an FSA.



## Q & A

- Q. Can TQ LTCI be offered as part of a Cafeteria (IRC 125) Plan?
- A. No, however, LTCI premiums may be paid through a Health Savings Account which can be included in a Cafeteria Plan.

**Source: Notice 2004-50, 2004-33**

**National Underwriter, Tax Facts 2006**





## Q & A

- Q. Are TQ LTCI premiums paid by an individual under an accelerated payment schedule (Flex Pay Riders) tax deductible as a medical expense?
- A. We are not aware of any tax authority specifically addressing the applicability of the medical expense deduction in cases where the insured voluntarily accelerates premium payments into the contract. The insured should consult with his/her tax advisor as accelerated payments may result in lost deductions that would have been available on level payments.
- For employer paid premiums, additional limitations can apply for accelerated premiums. Employer should consult with its tax advisor.



## Q & A

- Q. Is the amount of premium refunded to the insured's estate at death under MetLife's Return of Premium Rider taxable?
- A. Yes, refunds of premium are subject to estate tax regardless of who paid the premium. Estate pays income tax to the extent of the amount tax deducted by the insured/decedent from prior premiums paid. Estate pays income tax on entire premium if paid by the insured's/decedents employer.



## Q & A

- Q. Is the amount of premium refunded to the insured's individual beneficiary at death under MetLife's Return of Premium Rider taxable?
- A. Yes, returns of premium may be income taxable to an individual beneficiary. Beneficiary may have to pay income tax to the extent of the tax benefit from income tax deducted by the insured for prior premiums paid. Beneficiary pays income tax on entire premium if paid by the insured's/decedents employer.



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