Qualified Long-Term Care Tax Guide

Background

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) includes provisions for favorable tax treatment of long-term care (LTC) insurance contracts.

HIPAA provides that qualified long-term care insurance contracts will be treated, for tax purposes, as accident and health insurance, subject to certain rules and limits. Policies issued after January 1, 1997 that provide tax incentives are classified as tax-qualified plans.

In order to be tax-qualified, the long-term care policy must contain certain required provisions. Many of these provisions pertain to the manner in which future benefit payments can be triggered. If the policy contains all of the required language, it can generally be considered a Qualified Long-Term Care (QLTC) insurance contract for tax purposes. Some of the provisions are:

- The policy must be guaranteed renewable.

- In order for benefits to be paid, there must be the expectation that the disability will be long-term.

- The individual must be certified by a licensed health care practitioner within the last 12 months as “chronically ill.”

- The certification must be based on one or both of the following events. First is the inability to perform without human help, at least two of the six Activities of Daily Living (ADLs) for at least 90 days. The ADLs are eating, toileting, transferring, bathing, dressing and continence. Second is the need for substantial supervision due to severe cognitive impairment in order to protect the individual from threats to health and safety.

- Non-forfeiture benefits and benefit increase options (inflation protection) must be offered to the insured, but are not required as part of the policy.

- Benefits under a QLTC policy cannot duplicate Medicare benefits.

Policies issued before 1997 were considered “grandfathered” into the law and are considered tax-qualified. Policies issued after January 1, 1997 that do not provide tax incentives are classified as non-tax qualified plans.

Note: The income tax treatment of non-qualified plans is presently unclear. Under current law it appears that the premiums paid on a non-qualified long-term care policy may not be deductible.

Let’s review the tax treatment of premiums and benefits for qualified long-term care insurance purchased by:

- Individuals
- Sole-proprietors
- C-Corporations
- Partnerships, S Corporations, Limited Liability Corporations (LLCs)

Individuals

For a tax-qualified long-term care plan, an individual may include the premium (up to certain limits) as a medical expense that can be itemized under Schedule A and deductible to the extent that this premium, in combination with other medical expenses, exceeds 10 percent of adjusted gross income (7.5 percent for those 65 and over through 2016).

The maximum amount the individual may be able to deduct for premiums paid for each person depends on the person's attained age at the end of the tax year. In 2013, those limits are:

Age	2014 Eligible Premium
40 or younger	$370
41 through 50	$700
51 through 60	$1,400
61 through 70	$3,720
Older than 70	$4,660

Example:
Clients A and B file a joint return. Client A, age 64 has LTC premiums of $2,400. Client B, age 58 has LTC premiums of $1,200. The couple's AGI is $72,000 and other unreimbursed medical expenses total $5,100.

Unreimbursed medical expenses	$5,100
Qualified LTC premiums ($2,400 + $1,200)	$3,600
	$8,700
Medical expenses subject to 10 percent of $72,000	–$7,200
Allowable deduction	$1,500

Benefits
The benefits received from a tax-qualified long-term care policy to reimburse for actual expenses are generally excluded from an individual's income. However, if benefits are paid on a per diem basis, the amount that is excluded is limited to $330 per day for the tax year 2014. If the per diem benefit exceeds the daily benefit limit above, the excess amount is included in taxable income to the extent it exceeds the actual expense incurred for long-term care

Marketing Strategy
In addition to the tax benefits, individuals ages 40-50 can purchase long-term care insurance with lower premiums and a better chance of qualifying for the insurance. Individuals who strive to remain independent and pay for long-term care using long-term care insurance have numerous advantages:

- Avoid a waiting list
- Select a higher level of care
- Secure private accommodations versus a shared-room arrangement

Did You Know
83 percent of claimants agree that having their long-term care insurance made it easier to obtain needed services.

The 2010 Sourcebook for Long-Term Care Insurance Information

Sole-proprietors

Business Deduction

A sole-proprietor can deduct 100 percent of the eligible premium (subject to the age-based limits) for a qualified long-term care plan as a business deduction, provided the individual is not covered by a policy maintained by an individual's or spouse's employer. The deduction is available for the sole proprietor, spouse or dependents. In addition, an employer may generally deduct long-term care premiums paid for employees as a business expense.

Client A, age 64 and Client B, age 58 file a joint return. Client A, who is a sole proprietor has LTC premiums of $2,400 and Client B has LTC premiums of $1,200. The couple's AGI is $72,000 and other unreimbursed medical expenses total $5,500.

Since the LTC premiums are paid by the business, 100 percent of the eligible premium is deductible as an adjustment to income.

Income	$72,000
Qualified LTC premiums	– 2,400
Adjusted Income	$69,600

The spouse's eligible LTC premiums also receive the same favorable tax treatment.

Adjusted Income	$69,600	
Qualified LTC premiums	– 1,200	
Adjusted Income	$68,400	to further reduce the AGI.

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For example, Client C has a daily benefit of $350. If Client C's daily expenses are $280, the client would have a taxable income of $30 per day.

If Client C's daily expenses exceeded $350 per day, no taxable income would be incurred.

Marketing Strategy

In addition to stressing the tax advantages, consider the following when working with the business market.

- Employers can offer LTC as a perk to key executives
- Employers can offer LTC as an employee benefit on a voluntary basis or offer to cost-share the benefit.

Did You Know

The national average cost for a private room at a nursing home is $90,054 per year.

Mutual of Omaha's Cost of Care Survey conducted by Univata, 2012

C Corporations

Corporate entities may take a full business tax deduction for the premiums paid to purchase qualified long-term care coverage. Employers are allowed to arbitrarily select eligible employees/employee shareholders* to participate in the plan.

C Corporations can deduct the full premium (not just the eligible premium), for qualified long-term care plans, including coverage for the employee's spouse and dependents, as an ordinary and necessary business expense.

Premiums paid by the corporation are not included in the employee's income.

The benefits received from a tax-qualified long-term care policy to reimburse for actual expenses are generally excluded from an individual's income so long as the benefit does not exceed the greater of actual expenses and the per diem limit of $330 per day in 2014.

*Class of Employees

The officers and owners of a C Corporation may be employees and the corporation's contributions to the premium cost of qualified long-term care (QLTC) policies may be deductible by the corporation and not taxable to the employees if the contributions are made pursuant to an employee benefit plan.

If the QLTC employee benefit plan is insured, it need not conform to non-discrimination rules and may be available only to a select class of employees (IRC Section 106). The corporation must be able to show that the plan covers owner-employees as employees and not as owners. QLTC coverage may not use salary reduction dollars to pay its premium contribution.

If premiums are paid in advance, such as in a short pay sitiuation, the amount and timing of the deduction currently is unclear. The client should consult his or her tax advisor.

The information provided is not intended to be tax or legal advice. Consult your tax advisor to determine the benefits for your situation.

Partnership, S Corporation, Limited Liability Corporation (LLC)

The employer-paid portion of the long-term care premium is deductible as a general business expense including premiums for:

- Partners
- S Corporation shareholders of 2 percent or more
- LLC member (owners)
- Spouses and dependents of the above

Partners, S Corporation shareholders and LLC members are treated as self-employed and the income exclusion for employer provided long-term care does not apply. Premiums attributable to them and their spouses and dependents are included in their income and reported on their K-1. The deduction is determined the same way as for sole proprietors shown above.

Note: Clients should consult their tax advisor to determine the most advantageous deduction.

Business Deduction
Client G, age 48 owns an S Corporation. Her LTC premiums are $1,000 per year and she has an AGI of $85,500. Based on her age, she is allowed to deduct $700. She can deduct 100 percent of the $680 as a first-dollar tax deduction for 2013. This lowers her adjusted gross income.

Income	$85,500
Qualified LTC premium	– 700
Adjusted gross income	$84,800

Paying for the Employee
The employer-paid portion of the long-term care premium is taxable to an employee if it is provided through cafeteria plan or flexible spending account.

The employer-paid portion of the long-term care premium is excluded from the employee's taxable income.

The employee-paid portion of the premium may be deductible based on the rules for individual purchase.

Summary
The message given by Congress to consumers is, "Take care of your long-term care needs with private insurance because there aren't funds available to create a new entitlement program for everyone."

To further support this message, many states have state tax incentives for long-term care including: AL, AR, CA, CO, DC, HI, IA, ID, IN, KS, KY, LA, MD, ME, MN, MO, MT, NC, ND, NE, NJ, NM, NY, OH, OR, VA, WI and WV

Long-term care insurance offers choices and options for your clients. It may be the key factor for your clients to not outlive their money.