



Qualified Long Term Care Insurance

2006 Tax Treatment
of Premiums and Benefits

2006
Agent Guide

9 DEDUCTIONS
deduction is allowed
sold; cost of material

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Introduction

There are many compelling reasons for your clients to purchase long term care insurance, yet the perception that “it’s too expensive” continues to be one of the biggest obstacles in the sales process. While it’s important to focus on benefits of the policy coverage, a discussion of potential tax advantages may help overcome that common objection.

Thanks to the Health Insurance Portability and Accountability Act of 1996 (HIPAA), the IRS treats qualified long term care insurance policies like accident and health insurance. That means premiums and benefits of qualifying policies receive favorable tax treatment for individuals and businesses.¹ And because HIPAA has no nondiscrimination requirements for employer-provided plans, there exist some unique benefits for the business market.

This brochure will help agents understand and explain basic tax treatment of premiums and benefits for qualified long term care insurance policies. (As always, encourage your clients to consult their tax professional for specific advice on their individual situation.)

Topics covered in this guide include:

Tax treatment of benefits received

- Same provision for all benefit recipients.

Tax treatment of premiums paid

- Individuals
- Business:
 - Self-employed persons
 - C Corporations
 - Partnerships
 - S Corporations
 - Contributory arrangements

¹The provision does not include long term care insurance included in Cafeteria Plans and/or Flexible Spending Accounts.

Tax treatment of benefits received

Basic rule

Policy benefits that reimburse actual expenses for qualified long term care are exempt from taxable income.

Q. How does this rule affect a policy that pays “per diem” benefits?

A. For the tax year 2006, a per diem benefit up to \$250 per day is exempt from taxes. The IRS excludes from income the greater of either: a) a policyholder’s actual expenses for qualified long term care benefits, or b) the stated per diem benefit of \$250 per day.

Tax treatment example:

If an individual receives a daily benefit of \$250, and the daily benefit covers the actual expenses for qualified long term care benefits of \$250, the full \$250 is considered tax-exempt.

If, however, an individual receives a daily benefit of \$260 and actual expenses for qualified long term care benefits total \$100, then \$250 (the stated per diem exclusion) is considered tax-exempt and the additional \$10 (the amount in excess of the stated per diem) would be taxable.

Tax treatment of premiums paid

Individuals

Basic rule

Premiums and expenses for qualified long term care are personal medical expense deductions for individuals who itemize their tax return. (Internal Revenue Code Section 213.)

- Q.** Is the deductibility of long term care expenses subject to the 7.5% threshold for other medical expenses?
- A.** Yes. Only medical expenses – including long term care expenses – in excess of 7.5% of adjusted gross income (AGI) is tax deductible, up to the age-based, Eligible Premium Limit (see table, below).
- Q.** Are there other stipulations for tax deductibility of long term care premiums and expenses?
- A.** Yes. The age of the policyholder also determines the amount of premium that is deductible.

Age	2006 eligible premium limit
40 or younger	\$280
41 through 50	\$530
51 through 60	\$1,060
61 through 70	\$2,830
Older than 70	\$3,530

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000

1. In this example, the medical expense threshold is \$3,750 (7.5% of \$50,000 AGI). Since the total unreimbursed medical expenses are \$5,000, the threshold has been met. (The \$3,750 is the amount that is *not* deductible in this example.)
2. The 2006 eligible premium limit deduction is \$1,060. Only \$1,060 of the \$1,100 annual premium is deductible.

3. This example calculates to a total medical expense deduction of \$2,310, as shown here:

Unreimbursed medical expenses:	\$5,000
Less 7.5% of AGI	\$3,750
Subtotal (medical expense deduction)	\$1,250
Plus qualified LTC insurance premium, after applying the age-based, eligible premium limit:	\$1,060
Total Medical Expense Deduction	\$2,310

Tax treatment of premiums paid

Business: Self-employed

Basic rule for business deduction

A self-employed person may deduct 100% of the *eligible* premium for a qualified long term care insurance policy as an above-the-line business expense if a) the premium is paid by the business, and b) the individual is not covered by a long term care policy maintained by the individual's or spouse's employer.

Please note: The eligible premium is the actual, qualified long term care insurance premium – subject to the age-based, eligible premium limit – that is eligible for a "Schedule A" deduction. The deduction is limited to the individual's earned income.

Q. Is this benefit available to the spouse of a self-employed person?

A. Yes. The *qualified* long term care insurance premiums for the self-employed person's spouse and/or dependents receive the same tax benefit.

Basic rule for personal deduction

Eligible premium that is not deducted as a business expense may be included as a personal deduction.

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000

In this example, the entire eligible amount – \$1,060 – is deductible as a business expense. Remember, this provision is subject to the age-based, eligible premium limit. So it's 100% of that limit, which is \$1,060. However, in this case, the remaining \$40 of the total premium that was not deductible as a business expense may be included as a personal deduction.

Tax treatment of premiums paid

Business: C Corporations and professional corporations

Basic rule for business deduction

The company may deduct an employee's entire qualified long term care premium as a reasonable and necessary business expense. (Internal Revenue Code Section 162.)

Please note: If a company includes in the plan only stockholders employees, the IRS may treat the plan as a "stockholder" plan, not an "employee" plan. This treatment would mean the premium would not be deductible to the company, and the premium would be included in the stockholder's income as taxable dividends (Larkin vs. Comm, 48TC 629). To avoid this result, companies might consider including non-stockholders in the plan. Documenting in corporate documents that the plan covers a certain class of employees (e.g. all officers) is another way to help avoid this result.

Q. What about the cost of covering an employee's spouse?

A. The cost of long term care coverage for an employee's spouse and/or dependents is also deductible as a business expense.

Basic rule for personal deduction

Qualified long term care insurance premiums paid by an employer are excluded from the employee's income. (Internal Revenue Code Section 106.)

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000

In this example, the employee may generally exclude the entire premium from their taxable income. The company may deduct the entire qualified long term care premium as a reasonable and necessary business expense.

Tax treatment of premiums paid

Business: Partnerships and limited liability corporations

Basic rule for business deduction

If the participating employee is not a partner, the *eligible* insurance premium for qualified long term care for the employee, their spouse, and dependents is deductible by the business if the premium is paid by the business. The premium is not included in such employee's income.

If the participating employee is a partner, then LTCi premiums are deductible by the partnership and are included in the insured partner's gross income. The premium is then deductible as allowed under the special rules for health insurance costs of self-employed persons.

Basic rule for personal deduction

If the participating employee/partner deducts the *eligible* premium as a business expense, any remaining amount that was not deducted as a business expense may be deducted by the participant as a personal expense.

Please note: The eligible premium is the actual, qualified long term care insurance premium – subject to the age-based, eligible premium limit – that is eligible for a "Schedule A" deduction.

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000

1. **If the participating employee is not a partner**, the entire \$1,100 premium is a deduction for the business if the premium is paid by the business and excluded from the employee's taxable income.
2. **If the participant is a partner** (and is not covered by another plan through a spouse's employer) and the business pays the \$1,100 premium, the partner may deduct 100% of the *eligible* premium for a qualified LTCi policy as an above-the-line business expense. In this example, that means that 100% of \$1,060 is a reduction to the partner's adjusted gross income (AGI).

The medical expense threshold in this example is \$3,750 (7.5% of the \$50,000 adjusted gross income). The unreimbursed medical expenses, excluding the LTCi premium, are \$5,000, so the threshold is already met. A 58-year-old is allowed to deduct up to \$1,060 of qualified long term care insurance premium. In this example, the remaining eligible premium of \$40 that was not used as a reduction in adjusted gross income (AGI) may be taken as a personal deduction.

Tax treatment of premiums paid

Business: S Corporations

Basic rule for business deduction

If the participating employee does not own more than 2% interest in the S Corporation on any day during the tax year, the entire qualified long term care insurance premium for the employee, his or her spouse, and dependents is deductible by the business if the premium is paid by the business. The premium is not included in such employee's income.

If the participating employee does own more than 2% interest in the S Corporation, the employee is treated like a partner of a partnership. Premiums are deductible by the corporation and included in the employee/shareholder's income. The employee can deduct premiums subject to the limits of the special rules for health insurance costs of self-employed individuals.

Basic rule for personal deduction

A participating employee/shareholder who owns more than 2% interest in the S Corporation may take as a personal deduction whatever amount of the premium that was not a deductible business expense.

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000

1. **If the participating employee does not own more than 2% interest in the S Corporation**, the entire \$1,100 premium is deductible by the business, if paid by the business and excluded from the employee's taxable income.
2. In this example, **if the employee/shareholder does own more than 2% interest in the S Corporation** and the business pays the \$1,100 premium, that employee/shareholder may deduct the eligible premium for a qualified long term care insurance policy as an above-the-line business expense. That means \$1,060 is treated as a reduction to adjusted gross income (AGI) in this example. (See table on page 3 for the aged-based, eligible premium limit.)

The medical expense threshold in this example is \$3,750 (7.5% of the \$50,000 adjusted gross income). The unreimbursed medical expenses, excluding the LTCi premium, are \$5,000, so the threshold is already met. A 58-year-old is allowed to deduct up to \$1,060 of qualified long term care insurance premium as a business expense. In this scenario, the remaining eligible premium of \$40 that was not used to reduce AGI may be taken as a personal deduction.

Tax treatment of premiums paid

Business: Contributory arrangements

Basic rule for business deduction

When a C Corporation employer and its employee split the cost of a qualified long term care insurance premium, the company may deduct its premium contribution for an employee, their spouse, and dependents as a reasonable and necessary business expense. (Internal Revenue Code Section 162.)

Basic rule for personal deduction

If the participating employee/partner deducts the eligible premium as a business expense, any remaining amount that was not deducted as a business expense, may be deducted by the participant as a personal expense.

Please note: The eligible premium is the actual, qualified long term care insurance premium – subject to the age-based, eligible premium limit – that is eligible for a “Schedule A” deduction.

Tax treatment example using an Allianz qualified long term care insurance policy:

- Annual premium: \$1,100
- Purchased by: 58-year-old individual
- Unreimbursed medical expenses: \$5,000 (excluding premiums)
- Adjusted Gross Income (AGI): \$50,000
- Employer and employee split the \$1,100 premium, each paying \$550

1. In this example, the business deduction for the company would be \$550 (the half of the premium it paid for the employee).
2. The portion of the premium paid by the employee is treated the same as if paid by an individual, which means it’s treated as a personal medical expense deduction for individuals who itemize their tax return.

The medical expense threshold is 7.5% of the \$50,000 adjusted gross income, or \$3,750. The unreimbursed medical expenses, excluding the LTCi premium, are \$5,000, so the threshold is already met. A 58-year-old is allowed to include up to \$1,060 of the qualified LTCi premiums for tax year 2006. Since the portion of the premium personally paid by the employee in this example is \$550, the employee can deduct the entire amount as medical expense.

Notes:

Not intended as tax advice.

Your clients should see a qualified tax advisor or attorney for specifics about the tax treatment of premiums and benefits related to qualified long term care insurance.



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