

The Tax Advantages of Long-Term Care Insurance

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Call Reference Name: Prudential Long-Term Care

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This training material is designed to provide general information about the subject matter covered. It should be used with the understanding that Prudential is not rendering legal, accounting or tax services. Such services should be provided by the client's own advisors.

Intended Outcomes

- Understanding basic tax law rules regarding deduction of long-term care insurance premium
- Understanding the range of tax benefits available for different purchasers
- Identifying how understanding these rules can help sell long-term care insurance

Influence of Health Insurance Portability and Accountability Act (HIPAA)

- Qualified LTCi policies treated as accident and health insurance for income tax purposes
- Some tax advantages to individual
- Better tax advantages for S Corporations
- Strongest tax advantages for C Corporations

Treatment of Premium

- Treated as accident and health insurance premium
 - IRC sec. 7702B(a)(1)
- Premium deduction based on age - It is referred to as an eligible premium
 - IRC sec. 213(d)(10)
- Eligible premium is considered “medical care”
 - IRC sec. 213(d)(10)

Taxability of Benefit*

- 100% of proceeds on reimbursement policy are tax free
- If indemnity (or cash) first \$300** for actual cost of care is tax free:

Policy benefit:	\$320 / day
Actual cost of nursing home:	\$310 / day
Amount subject to tax:	\$10 / day

*IRC secs. 7702B(a)(2), 7702B(d), 104(a)(3)

**The amount for 2012, indexed for inflation

Deduction Rules

- Individual Purchase **(least tax benefit)**
 - After tax dollars with deduction subject to IRC LTC limits & other IRC deduction limits (7.5% of AGI)*
- Self-Employed and Employer Purchase for Owner **(some tax benefit)**
 - After tax dollars with deduction subject to IRC LTC limits, but not other deduction limits (above-the-line deduction not subject to 7.5% of AGI threshold, itemized deduction phase-out)
- Employer Purchase for Non-Owner Employee **(most tax benefit)**
 - Before tax dollars, not subject to IRC LTC limits or other IRC deduction limits (7.5% of AGI)

* Increases to 10% in 2013 for taxpayers under age 65 and in 2017 for taxpayers age 65 and older.

Rules for Individuals

- Unreimbursed medical expenses & LTC insurance premium deductible to extent they exceed 7.5% of Adjusted Gross Income (AGI)
- Higher salaried individuals or individuals with working spouses receive little tax benefit from eligible LTC premiums
 - Difficulty in reaching 7.5% AGI for medical expenses
 - Phase out of itemized deductions when AGI exceeds \$166,800 (2009 limit, indexed)*
 - Alternative Minimum Tax is higher – 10% of AGI
- Long-term care premiums **cannot** be paid on a pre-tax basis through Flexible Spending Account (FSA)

*The phase out was repealed through 2012 but is scheduled to be reinstated in 2013, adjusted for inflation from the 2009 amounts.

Maximum Tax-Deductible Premiums (2012)

2012 Eligible Premiums

Age 40 or below	\$350
Age 41 to 50	\$660
Age 51 to 60	\$1,310
Age 61 to 70	\$3,500
Age 71 and above	\$4,370

IRC 213(d)(10) limits (2012 as indexed for inflation)

Rules for Individual Premium Payment (2012)

Example: Based on AGI of \$60,000 & Annual Premium of \$2,400

\$1,310 **Determine age bracket** (58 yr individual)

+ \$6,000 Unreimbursed medical expenses (excluding LTC premium)

\$7,310

- \$4,500 Deduction allowed is the portion that exceeds 7.5% of AGI (\$60k x 7.5%)

\$2,810 Total Allowable Deduction

Rules for Employers and Non-Owner Employees

- Full premium deduction as business expense as long as it represents reasonable compensation
- Premium not included in gross income for employee
- Payments for qualified long-term care benefits not included in gross income
- Coverage can be provided to employee, spouse and dependents
- No discrimination rule applies to LTC insurance

3 Rules for Employers and Non-Owner Employees

Employer

Income w/out LTC premium	\$500,000
Increased wage to employee	\$3,236
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Employer net income	\$496,764

1.) Employee: Pays After Tax

Wages w/out LTC premium	\$100,000
Increased wage	\$3,236
Total AGI	\$103,236
7.5% AGI	\$7,743
Deduction for LTC premium	-0-

2.) Employee: Pays Before Tax*

Wages w/out LTC premium	\$100,000
Increased wage	\$0
Total AGI	\$100,000
7.5% AGI	\$7,500
Eligible LTC premium	-0-

3.) Employer Side

Income w/out LTC premium	\$500,000
LTC premium for employee	\$3,236
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Employer net income	\$496,764

* For payments from MSAs/HSAs/HRAs and is limited to the age based eligible premium.

Rules for Employers and Employees

ER v. EE Paid (Employer Benefits)

- Employer income tax results same either way **plus**
 - **Lower** payroll taxes
 - $(\$3,236 \times 1.45\% = \$47)$
 - **Lower** retirement plan contributions due to reduced salary
 - $(\$3,236 \times 25\% = \$809)$
 - Total savings for one employee = \$856
 - What about 10 employees? 100?

*Assumes that employee is over FICA wage limit - \$110,000 in 2012

Rules for Employers and Employees

ER v. EE Paid (Employee Benefits)

- Assuming tax rate of 40%
 - Employer payment of premium results in:
 - \$1,295 **tax saving** for employee just from \$3,236 reduction in AGI
- Employer paid premium reduces taxable income by full amount of LTC premium, not just eligible portion

Advantages: Employers and Employees

- Employer can create goodwill with employees while saving money
- Offer key employees better benefit package in a tax effective manner

Rules for Employee Owners

- **Self-Employed Individual**
 - Treated as health insurance premiums paid up to limit for eligible premiums based on age
 - Eligible premiums 100% deductible in determining AGI IRC 162(I)
- **C Corporation Owner***
 - Employer paid contribution fully deductible by employer
 - Employee owner treated same as all other employees

*Note that if the plan covers only stockholder-employees, need to have criteria other than stockholder to segregate group from other employees to sustain deductible insurance premium treatment instead of non-deductible dividend.

Self-Employed/Sole Proprietorship

- Premium is treated as self-employed health insurance premium
 - IRC sec.162(l)
- Owner deducts 100% of eligible premium from business income
 - Taken on line 29 Form 1040 (2011 Form 1040)
- Premium subject to self-employment tax (not deductible in calculating self-employment tax)
 - IRC sec.162(l)(4)
- Eligible premium for spouse & tax dependents also deductible

Limited Liability & Professional Corps

- LLC for tax purposes*
 - An LLC defaults to self-employed individual if only one person
 - An LLC defaults to a partnership if more than one person
- Professional corporation (PC) for tax purposes
 - Taxed either as C Corporation or S Corporation

*An LLC can elect corporate (C or S) or partnership/sole proprietor status

Rules For...

- **Limited Liability Corp (LLC) Employee Owners**
 - Employer paid contribution is fully deductible by employer
 - Employee owner includes premiums paid in gross income
 - Employee owner allowed eligible premiums 100% deductible in determining AGI
- **Partnership Employee Owners**
 - Partnership includes amount of premium paid for partner in partner's income as a guaranteed payment
 - Individual partner allowed eligible premiums 100% deductible in determining AGI

Partners: (Rev Rul. 91-26)

- Premium is a self-employed health insurance premium
 - IRC sec.162(l)
- Premium for partner can be deducted by partnership
 - IRC sec.162(a)
- Premium considered guaranteed payment to partner & reported on Form 1065 & K-1
 - IRC sec.707(c)
- Partner can deduct eligible premium
 - IRC sec.162(l), 213(d), 213(d)(10)
- Eligible premium for spouse & tax dependents also deductible

Rules for Employee Owners

- S Corporation (more than 2% owners)
 - Corporation treats premiums paid as wages and compensation (2% or less owners treated the same as all other employees)
 - Premiums included in W-2 wages
 - Shareholder allowed eligible premiums 100% deductible in determining AGI

Rules for Employee Owners

- Example for Self-Employed Individual, LLC Member, Partnership Partner or >2% Shareholder in S Corp.
- Assumptions:
 - Business has \$500,000 in income without long-term care insurance
 - Employee has \$100,000 in income
 - Employee is age 55
 - Long-term care insurance premium is \$3,236
 - Based on age, eligible LTCi premium is \$1,310

Rules for Employee Owners



Self-Employed Individual, LLC Member, Partnership Partner or >2% Shareholder in S Corp.

Employer:

Income w/out LTC premium	\$500,000
LTC premium for employee	\$3,236

Employer net income	\$496,764

Rules for Employee Owners

Self-Employed Individual, LLC Member, Partnership Partner or >2% Shareholder in S Corp. (Compare Employee vs. Owner Employee)

Employee:

Wages w/out	
LTC premium	\$100,000
Increased wage	0
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Total AGI	\$100,000

Owner Employee:

Wages/income w/out	
LTC premium	\$100,000
Increased income	\$3,236
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Total Income (TI)	\$103,236
Deduction from TI	
for Health Insurance	\$1,310
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Total AGI	\$101,926

Example: Alan Petersen dba Peterson Consulting (sole prop.)

Business income (Schedule C):	\$ 350,000
Eligible premium treated as self-employed health insurance deduction (age 61 – 70):	(\$3,500)
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Adjusted gross income:	\$346,500

Tax savings on \$3,500

Fed (28%):	\$980	Fed (33%):	\$1,155
<u>State (5%):</u>	<u>\$175</u>	<u>State (5%):</u>	<u>\$175</u>
Total savings:	\$1,155	Total savings:	\$1,330

Tax Strategy On Sale To Employee Owners

- Market as eligible premiums are an “above the line” deduction
- Is owner’s spouse bona fide employee?
Plan to provide coverage to that employee and their dependents
 - Approach does not work for S Corp. shareholder because of stock attribution rules

Model

- Purchase during the high income years
- Deductible as a business expense, including spouse coverage
- No imputed income (C Corp)
- Benefit paid TAX FREE
- Discriminatory participation
- Paid up in 10 years (where available)

Affluent

- Medicaid Never
- Current funding 100% Dollars
401(k)
Savings/Investments

Largest Silo to fund

Why the Affluent: Assets Over \$5M

Anyone who can afford LTCi should consider LTCi

- Integral part of estate and retirement plan
 - What is *your* written plan to deal with extended illness?
- Which funding method makes economic sense?
- Today's cost and the cost tomorrow
- Use today's \$s to protect against the cost tomorrow
- Why insure other areas?

Strategy

- Address tax incentives first
- Educate on the risk of LTC
- Create awareness of the need for personal protection from the risk
- Create urgency to act
- Explain how the program works

Key Statements

- Personal Wealth Accumulation
- Protect Assets
- Provide for Loved Ones
- Benevolent Employer
- Voluntary Benefit
- Reduce “Caregiver” Costs

Key Points

- Tax-Qualified
- Carve Outs
- Deductible Premiums
- No Income/Tax Free Benefits
- Group Discounts

State Income Tax Benefits

- States' treatment varies, but some provide a deduction, credit and/or tax free treatment of benefits
- Clients should discuss their state's tax treatment with their tax and legal advisors

Shareholders In C Corporation

- Corporation can deduct premium for any shareholder* regardless of % ownership
- Premium is not income to shareholder/employee
- Shareholder spouse's premium fully deductible to company and is not income to her
- Premiums of parents of shareholder deductible if claimed as tax dependents
- Employer not subject to anti-discrimination rule but IRS may watch for abuse

*Shareholder must be an employee. Company must have resolution in place.



Long-Term Care Insurance policies are issued by The Prudential Insurance Company of America, 751 Broad Street, Newark, NJ 07102 (800-732-0416).