

# Long-Term Care Insurance



## MetLife

# Guide to Federal Taxation







This *Long-Term Care Insurance Guide to Federal Taxation* is designed to provide producers with a general overview of the rules and regulations concerning how Long-Term Care Insurance (LTCI) premiums and benefits are treated under current tax laws. This guide is not approved for use in the sales process with your clients.

We have included examples that may reflect scenarios similar to your clients' particular situations. The examples are hypothetical and are shown for illustrative purposes only.

The tax information provided is based on MetLife's understanding of the federal tax laws in effect as of the date of this document. Such laws are subject to interpretation and legislative change. MetLife producers/financial planners are not authorized to practice law or to provide legal, accounting or tax advice. Therefore, your clients should consult with their legal or tax advisor regarding any tax issues pertaining to the purchase of long-term care insurance.

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# Tax Qualified LTCI Policy Requirements

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## What Makes a Long-Term Care Insurance Policy Tax Qualified?

When the Health Insurance Portability and Accountability Act of 1996 (HIPAA) was signed into law on August 2, 1996, it introduced and defined tax qualified (TQ) long-term care insurance (LTCI).

A TQ LTCI policy receives *favorable tax treatment* under existing federal tax laws by providing insurance protection for qualified long-term care services to a Chronically Ill individual, in accordance with a plan of care.

This means that anyone insured with a MetLife Individual LTCI policy will need to be certified as “Chronically Ill” by a licensed healthcare practitioner in order to become benefit eligible.

In addition, a TQ Long-Term Care Insurance policy:

- Must be guaranteed renewable;
- Must have no cash surrender value or other money that can be paid, assigned, pledged or borrowed;
- May not, in general, duplicate Medicare, or pay for items and services that are reimbursable by Medicare or would be reimbursable if not for a deductible or coinsurance;
- Must apply all refunds or dividends as a reduction of future premiums or an increase to future benefits, except upon death or total surrender of the policy;
- Must include a number of consumer protection provisions derived from the National Association of Insurance Commissioners (NAIC) Long-Term Care Insurance Model/Act Regulations as adopted as of January 1993 (or more stringent requirements as adopted by the state of policy issue).

MetLife’s Individual Long-Term Care Insurance policies are intended to meet these requirements.

## Non-Tax Qualified LTCI Policies

The Internal Revenue Code (IRC) does not specifically address the income taxation of premiums paid or benefits received from a Non-Tax Qualified LTCI policy. Since Congress has enacted favorable legislation for TQ LTCI, it is generally interpreted that this is an indication that Non-Tax Qualified LTCI policies will not receive the same favorable tax treatment.

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# Tax Qualified LTCI Policy Requirements

## What does “Favorable Tax Treatment” mean?

- For Federal income tax purposes, a TQ LTCI policy is generally classified as Accident and Health Insurance.<sup>1</sup>
- Benefits received from a TQ LTCI policy are not generally taxable as income.<sup>2</sup>
- Eligible premiums paid on TQ LTCI policies are treated as a medical expense so they can be itemized on an individual tax return, with other medical expenses, if they exceed 7.5% of Adjusted Gross Income (AGI).<sup>3</sup>
- Employer-paid TQ LTCI premiums for employees may be tax deductible to the employer.<sup>4</sup>
- Employer-paid TQ LTCI premiums, on behalf of an employee, are not included as income to the employee.<sup>5</sup>
- Benefits received from an employer-paid TQ LTCI policy are not generally taxable to the employee.<sup>6</sup>
- Any qualified long-term care expenses not covered by a long-term care insurance policy can also be treated as medical expenses and itemized on a tax return.
- Any LTCI policy issued prior to January 1, 1997, that met the long-term care insurance requirements of the state in which the contract was situated on the issue date is grandfathered in under HIPAA and will meet the definition of a TQ Long-Term Care Insurance Policy for Federal Tax purposes.<sup>7</sup>

## Terms You Should Know:

- **Qualified long-term care services** are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating and rehabilitative services and maintenance, or personal care services required by a Chronically Ill individual. Qualified services must be provided following a Plan of Care prescribed by a licensed health care practitioner.
- **Chronically Ill** means you need substantial assistance from another individual with at least two of six Activities of Daily Living (ADLs) and are expected to need assistance for at least 90 days due to a loss of functional capacity. The ADLs that are considered under most TQ Long-Term Care Insurance policies are: bathing, transferring, continence, dressing, toileting, eating.  
However, even if you can perform all of the Activities of Daily Living, you may still qualify for benefits if you require substantial supervision by another person to protect you from threats to health and safety due to a severe cognitive impairment.
- **Severe cognitive impairment** means a deterioration or loss in intellectual capacity, such as that associated with Alzheimer’s Disease.
- **Substantial assistance** means either hands-on or standby assistance.
- **Substantial supervision** means you require continual supervision (which may include cueing by verbal prompting, gesture or other demonstrations) by another person. Example: An individual may need to be reminded to take their medications, to dress properly or the individual may need someone to standby when he/she transfers from their bed to a chair.

1 IRC §7702B (a) (1), §7702B (a) (3)

2 IRC §104 (a)(3), §105(b), §7702B(a)(2), §7702B(d), §213(d)(1)

3 IRC §213(d)(1)(D), §213(a)

4 HIPAA, 1996, PL 104-491, IRC §7702B(a)(3)

5 IRC §106(a), §7702B(a)(3)

6 IRC §106(a), §7702B(a)(2), §7702B(d), §213(d)(1)

7 Treasury Reg. 1.7702B-2

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# Tax Treatment of Individually Purchased TQ LTCI Policies

## Federal Tax Treatment of Individual Taxpayer's Premiums

- A portion of TQ LTCI premiums paid in a calendar year, referred to as "eligible premiums," are treated as a medical expense.<sup>8</sup>
- These eligible premiums can be itemized on an individual tax return, along with other medical expenses.
- If the total of the itemized medical expenses exceed 7.5% of Adjusted Gross Income (AGI), the individual may take a deduction.

*To be eligible for long-term care premium tax deductions, an individual must have a tax qualified policy and itemize his/her expenses on a form 1040 Schedule A.*

**The deductible portion of the TQ LTCI premium, eligible premium is subject to age-based premium limitations, which are adjusted annually (see below).**

Maximum Deduction for Qualified LTCI Premiums Under Code §213(d)(10)	
Attained Age Before Close of Year	2010 Eligible Premium
40 or Less	\$330
More Than 40 But No More Than 50	\$620
More Than 50 But No More Than 60	\$1,230
More Than 60 But No More Than 70	\$3,290
More Than 70	\$4,110

Some states may allow a greater deduction to TQ LTCI premiums in computing state income tax.

### INDIVIDUAL TAX DEDUCTION EXAMPLE:

2010 Tax Year Individual TQ LTCI Premium Tax Deduction  
John, age 55, has a TQ LTCI Policy

#### Assumptions:

- Annual TQ LTCI Premium = \$2,600
- Adjusted Gross Income = \$70,000
- Other unreimbursed medical expenses = \$3,000
- 2010 maximum age-based "eligible LTCI premium" = \$1,230

#### Calculations:

- $\$70,000 \text{ (AGI)} \times 7.5\% = \$5,250$
  - $\$3,000 + \$1,230^{**} = \$4,230 - \$5,250 = (\$1,020)$
- \*\* Lesser of premiums paid or maximum "eligible long-term care insurance premium" for year.

#### Deduction:

- \$0 = Total Medical Expense Deduction (Medical Expenses do not exceed the 7.5% limitation)

<sup>8</sup> IRC §213(d)(1)(D)

# Tax Treatment of Individually Purchased TQ LTCI Policies

## Federal Tax Treatment of Benefits Paid from a TQ LTCI Policy

### Are Policy Benefits Considered Taxable Income?

- In general, if a person receives benefits under a TQ LTCI policy (other than dividends or premium refunds), the benefits are excluded from income the same as benefits received for personal injuries and sickness.<sup>9</sup>
- As such, benefits are treated as reimbursement for actual medical expenses incurred, regardless of whether the LTCI policy reimburses on the basis of actual expenses or pays benefits on a per diem or other periodic basis.
- Long-term care insurance benefits paid under a TQ LTCI policy on a reimbursement basis are generally tax-free. Under a **reimbursement** basis, the policy pays for actual long-term care charges incurred, up to the daily or monthly benefit that was selected.
- Benefits paid on a per diem or other periodic basis (including Cash Benefit or Indemnity) under a TQ LTCI policy are generally excluded from income, except for amounts that exceed the insured's total qualified long-term care expenses or an annual per diem limit, whichever is greater. Per diem benefits are paid without regard to the actual amount of costs incurred for qualified long-term care services.

This means when an insured starts receiving benefits from a **Reimbursement** policy, he/she will generally not have to count those benefit dollars as taxable income. If the insured is receiving benefits from a **per diem (Indemnity or Cash Payment)** policy, he/she may be required to count some of the benefit dollars as taxable income, if the benefits paid are greater than the cost of services received and greater than the IRC per diem limits (see below).

### 2010 Per diem Limits

LTCI benefits paid on a per diem or other periodic basis under a TQ LTCI policy are excluded from income subject to a maximum of the excess of the greater of:

- (a) \$290 per diem OR
- (b) actual TQ LTC expenses per day,  
MINUS
- (c) any reimbursement received for these expenses.

**Q.** A client wishes to pay the premium of TQ LTCI on behalf of a parent who is not a qualified dependent.\* Will the client be entitled to a medical expense deduction on his/her taxes?

**A.** No. The individual would not be able to deduct any of the premium paid on behalf of a person who is not a qualified dependent.

\* A qualified dependent is generally defined as someone who is at least 50% financially dependent upon the taxpayer and meets the appropriate relationship tests required under §152 of the Internal Revenue Code

<sup>9</sup> IRC §7702B(a)(2), §104(a)(3), §105(b)

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# Tax Treatment of Individually Purchased TQ LTCI Policies

## Taxation of LTCI Benefits Examples:

### VIP2 Product:

#### 2010 TQ LTCI Policy Benefit Taxation

- Mary, age 84, has a MetLife Value Policy with Indemnity Rider and a Daily Benefit Amount (DBA) of \$300.
- Mary becomes Chronically Ill and receives Home Care Services at a cost of \$200 per day.
- MetLife pays Mary a per diem benefit of \$300 per service day, which is **\$100** in excess of the cost of Mary's long-term care services, and **\$10** in excess of the annual per diem limit for 2010 of \$290 per day.
- Because the per diem limit is greater than the cost of Mary's long-term care services, the per diem limit is used to calculate Mary's taxable income.\* Mary's taxable income is the DBA less the per diem limit.
- Accordingly, **\$10** of the excess payment would be taxable income to Mary ( $\$300 - \$290 = \$10$ ).

### LifeStage Advantage Product:

#### 2010 TQ LTCI Policy Benefit Taxation

- Tom, age 76, has a MetLife LTC LifeStage Advantage Policy<sup>SM</sup> with the Cash Benefit Rider
- The Monthly Benefit Amount is \$9,000
- Tom becomes Chronically Ill and receives Home Care Services at a cost of \$7,500 per month (\$250 per day for 30 days).
- MetLife pays Tom a monthly cash benefit amount of \$9,000, which equates to \$300 per day in a 30-day month.
- The benefit being paid is **\$50** in excess of the daily costs incurred for Tom's long-term care services, and **\$10** in excess of the annual per diem limit for 2010 of \$290 per day.
- Because the per diem limit is greater than the cost of Tom's long-term care services, the per diem limit is used to calculate Tom's taxable income.\* Tom's taxable income is the per day benefit amount, minus the per diem benefit, times the number of days receiving the benefit.
- Accordingly, **\$10** of the excess payment would be taxable income to Tom ( $\$9,000 / 30 \text{ days} = \$300 \text{ per day. } \$300 - \$290 = \$10$ ) for each day Tom receives the benefit. In this example, the total taxable income would equal \$300 per month ( $\$10 \times 30 \text{ days}$ ).

\* Taxable Income equals policy benefit payment minus the greater of the per diem limit or long-term care expenses incurred (assuming no other reimbursements received under another long-term care insurance policy or as an accelerated death benefit under a life insurance policy).

# Tax Treatment of Employer-Paid TQ LTCI Policies

## Employer-Paid TQ Long-Term Care Insurance Premiums

Business owners can offer long-term care insurance to employees on an employer-paid or voluntary (employee-paid) basis.

- TQ LTCI benefits received by insureds (from either employer-paid or voluntary policies) are generally tax free, except if a per diem benefit is received in excess of TQ LTCI expenses incurred and/or the IRC annual per diem maximum (whichever is greater), less reimbursements from all sources including Medicare and other insurance. (See page 6 for more information)

## If TQ LTCI Premiums Are Employer-Paid:

- Generally, TQ LTCI premiums paid on behalf of employees and their spouses/qualified dependents may be tax deductible to the employer (details of tax deductibility are specific to the type of business—see pages 9–12 for more information).
- In order to be deductible to the business, the TQ LTCI premiums must be reasonable compensation for personal services rendered within the meaning of IRC §162.
- There is no income tax to the employee for TQ LTCI premiums paid by their employer on their behalf pursuant to an employee long-term care benefit plan.
  - Employer-paid TQ LTCI premiums are excluded from an employee’s gross income because TQ LTCI is treated as Accident and Health Insurance for tax purposes.<sup>10</sup>
  - Generally, long-term care insurance may not be offered through a cafeteria plan. As a result, TQ LTCI premiums and expenses are not considered tax-free under a flexible spending account.<sup>11</sup>

If an individual leaves a company, his/her LTCI coverage is portable, regardless of who is paying the premium. If the employer was paying the premiums, the individual would then assume responsibility for payment of premiums.

## Nondiscrimination Rules and Executive Carve-Outs

In some cases, an employer may wish to pay the TQ LTCI premiums for a select group of employees, often referred to as a “carve-out” plan.

- There are generally no highly compensated nondiscrimination rules that apply to TQ LTCI policies.
- However, there may be other rules or laws that limit how an employer can select a specific group of employees in the payment of employees’ TQ LTCI premiums (such as Title VII of the Civil Rights Act of 1964).
- Business owner clients should review all federal and state laws, as well as ERISA requirements before deciding upon an employer-paid carve-out plan.

## Payment of TQ LTCI Premiums for Domestic Partners of Employees

- Employers are able to pay the TQ LTCI premium for an employee’s domestic partner and receive a tax deduction if the domestic partner can qualify as a dependent of the employee under IRC §152.
- If the domestic partner is not a qualified dependent of an employee and the employer pays the domestic partner’s TQ LTCI premium, the premium paid would be included in the employee’s gross income and the employer would get a tax deduction for wages paid.

<sup>10</sup> IRC §7702B(a)(3) , 106(a)  
<sup>11</sup> IRC §106(c)

# C-Corporations Paying LTCI Premiums

- **Impact to the Business:** When a C-Corporation pays the premium (full or partial) on TQ LTCI policies for bona fide employees, their spouses and their qualified dependents, the C-Corporation generally can deduct 100% of the premium paid as a reasonable business expense, regardless of whether the employee has ownership in the business.<sup>12</sup>
- **Impact to the Owner(s):** C-Corporation owners are treated like any other employee, when premiums are paid in relation to the owner's capacity as an employee.
- **Impact to the Employees:** The employee will not need to declare premiums paid as income on personal income tax forms, and any LTCI benefits received will generally be tax free.

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 insurance premiums.

## Payment of TQ LTCI Premium for a Non-Employee Board of Directors Members

If a C-Corporation decides to pay the TQ LTCI premium for a non-employee Board of Directors member, the premium is probably deductible to the Corporation as a fee paid to the Director. The premium paid would represent income to the Director. The Director should be able to treat the premium as a deduction subject to the rules applicable to other individual sole proprietors (see page 11).

### Shareholders:

If a C-Corporation purchases a TQ LTCI policy for a shareholder who is not otherwise an employee, no deduction is available to the C-Corporation and the premiums represent dividend income to the shareholder.

### C-CORPORATION TAX DEDUCTION EXAMPLE:

- The LMNO Company is offering LTCI to all of its employees as part of a Multi-Life Discount Program.
- The company is offering to pay \$100 a month in premiums for each employee.
- There are 15 employees who take advantage of this opportunity.
- The company pays  $\$100 \times 15 \text{ employees} \times 12 \text{ months} = \$18,000$  per year in premiums.
- Company potential deduction = \$18,000.
- The 15 employees would be able to include the portion of premium each of them actually pay to their own itemized medical expense deduction, following the individual tax deduction rules on page 5.
- For example:
  - Dave's total premium is \$200 a month (\$2,400 a year).
  - LMNO Company is paying \$100 a month (\$1,200 a year).
  - Dave is required to pay \$100 a month (\$1,200 a year).
  - He is 52 years old, therefore he can add up to his "Eligible Premium" of \$1,230 to his other unreimbursed medical expenses. If his total unreimbursed medical expenses exceed 7.5% of his AGI, he will have a tax deduction (see page 5 for more information on individual tax deductions).

<sup>12</sup> IRC §7702B(a)(3)

## S-Corporations Paying LTCI Premiums

- **Impact to Business:** TQ LTCI premiums paid by an S-Corporation on behalf of owners of 2% or more of stock and/or employees (and spouses/dependents) are tax deductible as a reasonable and necessary business expense.
- **Impact to Owner(s):** Owners of 2% or more of stock must declare any employer-paid premiums paid on their behalf, or on behalf of their spouses/dependents, as income, then are able to deduct 100% of the maximum "eligible TQ long-term care insurance premiums" (refer to page 5) their personal income tax forms.
- However, there is no deduction allowed 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.
- **Impact to Employees:** Employees (not owners of 2% or more of stock) who receive employer-paid LTCI, will not need to declare premiums paid as income, and any LTCI benefits received will generally be tax free.

S-Corporations (including a Professional Corporation [PC] and Personal Services Corporation [PSC]) are treated as "Self-Employed" for tax purposes.

### S-CORPORATION TAX DEDUCTION EXAMPLE:

Bob, age 68, and Sue, age 65, are a married couple who own a small business (both own more than 2% of the stock).

The business purchases TQ LTCI for both of them and their one employee.

- TQ LTCI Annual Premiums paid by the business for:

Bob	\$5,800
Sue	\$4,300
Employee	\$2,200
Total	\$12,300

- S-Corporation Potential Tax Deduction = \$12,300
- The premiums paid on behalf of Bob and Sue are reported as income to each owner equal to premium paid by the S-Corporation.

### OWNERS' PERSONAL TAX DEDUCTION EXAMPLE:

- TQ LTCI premium paid on their behalf, declared as income: \$10,100
- 2010 "Eligible" premium Bob and Sue = \$3,290 each
- 2010 Tax deduction calculation (filing jointly as a married couple)
  - Total combined 2010 "eligible" premium = \$6,580
  - \$6,580\* x 100% = \$6,580 potential tax deduction

\* Lesser of premiums paid or maximum "eligible long-term care insurance premium" for year.

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## Sole Proprietor Paying LTCI Premiums

- **Impact to Business:** Premiums paid on behalf of employees, their spouses and their dependents for TQ LTCI policies are generally fully tax deductible (not subject to eligible premium limitations) as a reasonable business expense.
- **Impact to Owner(s):** The owners of these entities must declare premiums paid on their behalf (and on behalf of a spouse or dependent) as income, and then can deduct 100% of the maximum “eligible TQ long-term care insurance premiums” (refer to page 5) paid on their behalf, including premiums paid for their spouses and qualified dependents, for TQ LTCI policies.<sup>13</sup>
  - However, there is no deduction allowed 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.
- **Impact to Employees:** Employees who receive employer-paid LTCI, will not need to declare premiums paid as income, and any LTCI benefits received will generally be tax free.

Sole Proprietors are treated as “Self-Employed” for tax purposes.

### SOLE PROPRIETOR TAX DEDUCTION EXAMPLE:

James, age 51, a self-employed plumber, purchases a TQ LTCI Policy for himself, his wife, Peg, age 48, and his one employee.

- TQ LTCI Annual Premiums paid by the business for:

James	\$1,700
Peg	\$1,400
Employee	\$1,000
Total	\$4,100

- James’s 2010 “eligible LTCI premium” = \$1,230
- Peg’s 2010 “eligible LTCI premium” = \$620
- TQ LTCI premium paid on their behalf, declared as income: \$3,100

- **2010 Potential Tax Deduction = \$2,850**

$(\$1,230 * [100\% \text{ of James's eligible premium}] + \$620 * [100\% \text{ of Peg's eligible premium}] + \$1,000 \text{ [employee's total premium]})$

\* Lesser of premiums paid or maximum “eligible long-term care insurance premium” for year.

<sup>13</sup> IRC §7702B(a)(3), §162(l) and §213(d)(10)

## Partnerships Paying LTCI Premiums

- **Impact to Business:** Premiums paid on behalf of partners (for services rendered by the partner, in his/her capacity as an employee), non-partner employees, their spouses and their dependents for TQ LTCI policies are generally fully tax deductible (not subject to eligible premium limitations) as a reasonable and necessary business expense.<sup>14</sup>
- **Impact to Partner(s):** If the Partnership purchases a TQ Long-Term Care Insurance policy for a partner (in his capacity as a partner), the partner will be considered a self-employed individual for tax purposes. Additionally, if the premiums are paid by the Partnership, the premiums will represent income to the partner.<sup>15</sup>
  - The partner must declare the premium paid on their behalf (and on behalf of their spouse/dependents) as partnership income. The partner would then be able to deduct 100% of the “eligible premium” (refer to page 5) on their personal tax forms.
  - However, there is no deduction allowed if the partner 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.
- **Impact to Employees:** Non-partner employees who receive employer-paid LTCI, will not need to declare premiums paid as income, and any LTCI benefits received will generally be tax free.

Partnerships (including LLCs) are treated as “Self-Employed” for tax purposes.

### PARTNERSHIP TAX DEDUCTION EXAMPLE:

- Mary, age 45 and Joan, age 51, are partners in a Home Design business.
- The Partnership (business entity) purchases a TQ LTCI Insurance policy for both of them.
- Annual TQ LTCI Premiums Paid:
  - Mary = \$1,600
  - Joan = \$2,500
- Partnership (business entity) Tax Deduction = \$4,100 (Total premiums paid for Mary and Joan.)

The premiums paid are reported as income to each partner, who may then deduct such amounts as shown on the right.

### PARTNERS’ PERSONAL TAX DEDUCTION EXAMPLE:

- Mary, Age 45
  - TQ LTCI Premium = \$1,600
  - 2010 “eligible LTCI premium” = \$620
  - \$620\* Personal Tax Deduction (100% x \$620)
  - Total Premium of \$1,600 reported as income
- Joan, Age 51
  - TQ LTCI Premium = \$2,500
  - 2010 “eligible LTCI premium” = \$1,230
  - \$1,230\* Personal Tax Deduction (\$1,230 x 100%)
  - Total Premium of \$2,500 reported as income

\*Lesser of premiums paid or maximum “eligible long-term care insurance premium” for year.

<sup>14</sup> IRC §7702B(a)(3)

<sup>15</sup> IRC §162(1), 213(d), 162(1)(2)(C)

# Health Spending Accounts, Flexible Spending Accounts and Cafeteria Plans

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## Health Spending Accounts (HSA)

- An HSA is a trust created or organized in the U.S. to pay for qualified medical expenses (including LTC expenses and LTCI premiums) 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 §223(c)(2)).
- Individual contributions to the account are tax deductible and payments from the account for qualified medical expenses are not taxable.
- TQ LTCI premiums and long-term care expenses are considered qualified medical expenses, and can be paid for from an HSA.
- Please note that this is a very brief summary of complex rules that govern HSAs.

Many HSAs require a person to draw funds via a credit card to pay for qualified expenses. However, some carriers, including MetLife, do not accept credit cards for payment of LTCI premiums at this time. An applicant should be aware of any limitations, if they are interested in using an HSA to pay for their LTCI premiums.

## Flexible Spending Accounts (FSA)

- A Flexible Spending Account (FSA) is a tax-favored program offered by employers that allows their employees to pay for eligible out-of-pocket health care and dependent care expenses with pre-tax dollars.
- At this time, long-term care insurance premiums are not considered an eligible expense, therefore FSA amounts may not be used to pay for LTCI premiums.

## Cafeteria Plans

- Cafeteria Plans allow employees to obtain benefits such as health or dental insurance, through a pre-tax payroll deduction.
- TQ LTCI policies may not be offered to employees through a Cafeteria Plan, however, LTCI premiums may be paid through an HSA, which can be included in a Cafeteria Plan.<sup>16</sup>

# Tax Implications With a Return of Premium Feature/Rider

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- Many TQ LTCI policies offer a Return of Premium feature or optional rider.
- Details of the feature/rider may vary per policy and state requirements, however, generally, a Return of Premium feature/rider means that premiums paid into a policy, minus any claims paid or payable, will be refunded to the insured's estate or designated beneficiary, if the insured dies.
- Premium refunded to the insured's/decedent's estate:
  - The premium refunded to the insured's estate at death are subject to estate tax.
  - The estate pays income tax to the extent of the amount tax deducted by the insured/decedent from prior premiums paid.
  - If the TQ LTCI premiums were originally paid for by insured's/decedent's employer, the estate pays income tax on entire premium.
- Premium refunded to an individual beneficiary:
  - The beneficiary may have to pay income tax to the extent of the amount tax deducted by the insured/decedent from prior premiums paid.
  - If the TQ LTCI premiums were originally paid for by the insured's/decedent's employer, the beneficiary pays income tax on the entire premium refunded.

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# Additional Potential Limitations Employer's Tax Deductibility

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 insurance premiums. For example, the employer is limited to only deducting reasonable compensation costs. To the extent that the payment of premiums would be considered unreasonable compensation, the employer would not generally be able to take the deduction. Although not entirely clear, it appears unlikely that an employer could take a current deduction for the entire premium paid each year on a limited pay policy, such as a 10-pay plan.

LTCI Tax Benefit Summary Chart* for Employer-Paid Coverage				
	C-Corporation	S-Corporation	Partnerships	Sole Proprietor
Business Tax Deduction	100% of premiums paid by employer for employees, employees' spouses & qualified dependents are deductible	100% of premiums paid by employer for employees, employees' spouses & qualified dependents are deductible	100% of premiums paid by employer for employees, employees' spouses & qualified dependents are deductible	100% of total premiums paid by employer for employees, employees' spouses & qualified dependents are deductible
Personal Tax Deduction to Owners	None	2% or more owners can deduct 100% of "eligible" premiums paid for themselves, their spouses & qualified dependents on their personal tax return	Partners can deduct 100% of "eligible" premium paid for themselves, their spouses & qualified dependents on their personal tax return	The owner can deduct 100% of "eligible" premium paid for themselves, their spouse & qualified dependents on their personal tax return
Income Tax to Employees for Premium Paid on Their Behalf	Generally none	Generally none	Generally none	Generally none
Income Tax to Owners for Premiums Paid on Their Behalf	Generally none	Owners must declare premiums paid on behalf of themselves, their spouses and qualified dependents as income	Partners must declare premiums paid on behalf of themselves, their spouses and qualified dependents as income	Owners must declare premiums paid on behalf of themselves, their spouses and qualified dependents as income

\* Employers should consult with their own tax and legal advisors. The IRS Tax Codes that reference this summary are as follows: 104(a)(3), 162(l), 213(d), 7702B(a), 7702B(a)(3), 7702B(d)(2), Rev. Proc. 2008-66

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