2020 Tax Implications

of Long Term Care Insurance (LTCi) for Individuals and Businesses

Massachusetts Mutual Life Insurance Company

LTC6101

What are the Tax Implications of LTCi for Individuals and Businesses?

Individual

Premiums paid by an individual for qualified LTCi are treated as a medical expense for purposes of itemizing medical expenses. The amount that can be used in calculating the expense deduction is limited to the lesser of actual premium paid or “eligible long term care premium” defined as follows:

ATTAINED AGE BEFORE CLOSE OF 2020 TAXABLE YEAR:

Age 40 or less:	$430
More than 40 but not more than 50:	$810
More than 50 but not more than 60:	$1,630
More than 60 but not more than 70:	$4,350
More than 70:	$5,430

The amount of premium paid for the coverage of the individual, spouse and dependents may be deducted to the extent that total medical expenses, including the eligible long term care premium, exceeds 7.5%[1] of adjusted gross income (AGI).

Benefits paid on a qualified LTCi policy to an individual are not taxable income as long as benefit payments above $380 per day do not exceed the actual cost of care.

[1] The 7.5% threshold applies for tax years 2017-2020. For tax years beginning January 1, 2021 or later, the threshold will revert to 10%.

Sole Proprietor

Sole proprietors can deduct the full premium paid for LTCi coverage they provide their employees. With respect to their own coverage, the sole proprietor can deduct 100% of the eligible long term care premiums. “Eligible long term care premium” is defined in the table above. There is no 7.5% of AGI threshold requirement.

A sole proprietor can deduct the full premium paid for LTCi coverage if his/her spouse is an employee and he/she provides family coverage for the employee-spouse. The employer-spouse is then covered by the plan as a member of the employee’s family. If the employee-spouse is a bona fide employee, the cost of the coverage is fully deductible by the employer-spouse and excludable from the employee-spouse’s gross income.

Partnership

When a partnership pays for LTCi coverage on its partners, it can deduct premiums that qualify as “guaranteed” payments under the Internal Revenue Code (IRC) Section 707(c). LTCi premiums constitute guaranteed payments if they are paid for services rendered by the insureds in their capacity as partners, without regard to partnership income. Since partners are not employees, they cannot use IRC Section 106(a) to exclude from their gross income the LTCi premiums paid by the partnership. Although partners must include the full amount of such premiums in their gross income, they can deduct a portion of the premiums paid. The same rules that limit the deduction a sole proprietor can take for his or her long term care premiums also limit the premiums that a partner can deduct. Members in a limited liability company (LLC) taxed as a partnership are subject to these same limitations.

If a spouse is a bona fide employee of a partnership or LLC, the same rules regarding deductibility and exclusion from gross income that are described in the section on Sole Proprietor apply.

S Corporation

For fringe benefit purposes, a 2% shareholder of an S corporation is treated like a partner in a partnership. Therefore, an S corporation can deduct the LTCi premiums it pays in consideration for services rendered by the insured shareholder, and the shareholder must include the full premium in his or her gross income. As with sole proprietors and partners, a 2% shareholder in an S corporation can deduct only a limited portion of the LTCi premiums. A 2% shareholder is defined in IRC Section 1372 as "...any person who owns (or is considered as owning within the meaning of Section 318) on any day during the taxable year of the S corporation more than 2% of the outstanding stock of such corporation or stock possessing more than 2% of the total combined voting power of all stock of such corporation." IRC Section 318 provides rules for the constructive ownership of stock (the attribution rules). Under these rules, an individual is deemed (i.e., considered) to own stock owned directly or indirectly by his parents, spouse, children and grandchildren.

C Corporation

Employer provided long term care insurance qualifies as an accident and health plan within the meaning of IRC Sections 105(b) and 106.

Employer Deduction – LTCi Premiums

When an employer pays the premium for qualified long term care coverage for its employees, the employer should be able to deduct those premiums as an ordinary and necessary business expense to the same extent that it can deduct premiums paid for other accident and health insurance covering its employees (IRC Section 162). However, an employer cannot provide long term care coverage as part of a cafeteria plan (IRC Section 125(f)).

Employee Income – LTCi Premiums

Under IRC Section 106(a), an employee does not have to include in gross income the cost of any employer-provided coverage under an accident or health plan. Consequently, with one exception, premiums paid by an employer for an employee's qualified long term care insurance are not includable in the employee's gross income. If employer-paid premiums for qualified long term care coverage are not included in the employee's gross income, then the employee cannot take an income tax deduction for those premiums. However, if an employer provides long term care coverage through a flexible spending arrangement, the employee must include the cost of that coverage in gross income (IRC Section 106(c)). Accordingly, the employee's medical expense deduction is then limited to the lesser of actual premium paid or the eligible long term care premium, and the normal threshold of 7.5%[1] of AGI applies.

Employee Income – LTCi Benefits

The general rule is that any benefit received by an employee through accident or health insurance for personal injuries or sickness is included in the employee's gross income if the employer paid for

[1] The 7.5% threshold applies for tax years 2017-2020. For tax years beginning January 1, 2021 or later, the threshold will revert to 10%.

the coverage and the employer-paid premiums were not included in the employee's income when paid (IRC Section 105(a)). This general rule does not apply to amounts paid to reimburse the employee, directly or indirectly, for medical care expenses incurred by the employee, the employee's spouse or the employee's dependent (IRC Section 105(b)). Amounts received under a qualified long term care insurance contract are treated as reimbursements for expenses actually incurred for medical care (IRC Section 7702B(a)(2)). As a result, if an employer pays the premium for an employee's qualified long term care coverage, the employee will NOT be taxed on the long term care benefits paid under the insurance — those benefits are treated as a non-taxable reimbursement for medical care. The result is the same whether the insurance reimburses actual long term care expenses or pays a per diem amount toward long term care. However, if the insurance pays a per diem benefit that exceeds the per diem limit provided under IRC Section 7702B(d) ($380 in 2020), the excess is taxable income to the employee unless the employee's actual long term care expenses equal or exceed the per diem benefit paid.

Shareholder Employees

LTCi premiums paid by a C corporation on behalf of any shareholder are treated as non-deductible dividends, unless the corporation can establish that it is providing coverage to the insured in his or her capacity as an employee. When LTCi

coverage is provided only to shareholder-employees, the corporation must demonstrate that there is a reasonable basis, other than their status as shareholders, to separate the insured individuals from non-shareholder employees who do not receive coverage. If a corporation cannot deduct LTCi premiums — because the premiums are treated as a dividend to a shareholder — the insured must include the entire premium in gross income. Again, IRC Section 106(a) only allows employees to exclude from gross income the cost of employer-provided LTCi coverage. If a corporation can establish that coverage is being provided to the insured in his or her capacity as an employee, the same rules will apply as for coverage provided to other employees — i.e. the corporation can deduct the premium and the premiums will not be taxable income to the shareholder-employee.

Health Savings Account (HSA)

Expenses for long term care services and premium payments for a qualified long term care insurance policy (subject to the eligible long term care premium limits) are considered to be “qualified medical expenses” as defined in IRC Section 223, which establishes the rules for Health Savings Accounts (HSA). As such, money in an HSA can be used to pay these types of expenses. An HSA is an account that you can put money into to save for future medical expenses.

To be eligible to open an HSA, a person must have coverage under an HSA-qualified high deductible health plan (HDHP), have no other first-dollar medical coverage, not be enrolled in Medicare, and not a dependent on someone else’s tax return. Contribution levels are determined by the effective date of the HDHP coverage. Money in the account can be used to pay for medical expenses for yourself, your spouse, or your dependent children.

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