Nationwide CareMatters II®

Tax treatment for business owners and employees

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KEY HIGHLIGHTS

- **Nationwide cash indemnity story**
- **Tax treatment applying to all of Nationwide LTC benefits**
- **Structure of CareMatters II and how it affects the general policy**
- **CareMatters II corporate and business opportunities**
- **LTC coverage for business owners and employees**
- **Age-based limits for self-employed business owner's LTC premiums**
- **Sole-proprietorships – CareMatters II for the owner**
- **Purchasing CareMatters**
- **Company-owned CareMatters II**
- **Designing a CareMatters II policy for ultimate tax advantages**

This paper is intended primarily to provide information regarding the tax treatment of Nationwide's CareMatters II long-term care products that are intended for use as employee or owner/employee benefits. It is not intended to provide tax or legal advice or be a substitute for tax and/or legal counsel. Clients should consult their own legal and/or tax advisor concerning their individual situations.

Insuring for potential long-term care (LTC) needs is an important aspect of a person's overall financial strategy. This protection can help shield a couple's or individual's portfolio from depletion due to LTC costs as well as provide choice and flexibility in planning for LTC needs. Being able to offer such coverage to executives or valued employees can help recruit, reward, and retain valuable individuals. For the business owner, certain types of LTC coverage can be purchased though the business in order to maximize tax deduction opportunities.

LTC coverage comes in many forms from traditional LTC insurance (LTCi) to combination (combo) and hybrid policies that place LTC riders on life insurance and annuities. These combo and hybrid solutions provide LTC benefits without the risk of losing premium dollars paid if the LTC benefits are little or never used. However, there will be some variances in the tax treatment of combo and hybrid LTC products compared to traditional long-term care insurance depending on the design of the product.

NATIONWIDE LTC SOLUTIONS — IRC §7702B

Nationwide offers several LTC product solutions. It is important to note that all LTC products offered by Nationwide are intended to be Qualified Long-term Care Contracts under Internal Revenue Code IRC §7702B. However, due to differing product structures, CareMatters II will offer far more tax advantages than other Nationwide LTC product solutions. This paper will be focused on CareMatters II — however, we will briefly discuss tax preferences regarding other Nationwide LTC products when applicable.

NATIONWIDE — PAYING CASH INDEMNITY LTC BENEFITS

All Nationwide LTC products, including CareMatters II, pay LTC benefits by cash indemnity - and Nationwide places no restrictions on how LTC benefits are used by the recipient. In addition, all Nationwide LTC claims - regardless of the specific product - will be processed under the identical claim procedure. The policy owner is eligible to be paid the maximum available monthly LTC benefit but may take less if desired. All LTC benefits collected are considered to be a distribution of LTC benefits to the policy owner. LTC benefits are generally tax free, subject to IRS limitations.

It is the policy owner's obligation to submit the proper documentation for claims requirements. Once all claims requirements have been met, no monthly paperwork is required to receive the monthly LTC benefits. Regulations require that an insurance company paying qualified LTC benefits (which includes Nationwide) must:

- recertify all LTC claims at least once every 12 months, and
- require submission of a Plan of Care for the insured as part of the claims and recertification process.

TAX TREATMENT APPLYING TO ALL NATIONWIDE LTC POLICY SOLUTIONS

The importance of HIPAA and IRC §7702B
IRC §7702B defines a Qualified Long-term Care Insurance Contract (which includes LTC Riders and Linked Benefit LTC policies) as well as the potential tax-deductibility of premiums paid and tax treatment of LTC benefits received by the policy owner. HIPAA (which will be referenced throughout this paper) refers to the Health Insurance Portability and Accountability Act of 1996, which enacted IRC §7702B.

LTC benefits are generally paid tax-free
LTC benefits will be tax free as long as the amount received is within the IRS limits. The governing provision defines the amount of tax free LTC benefits as follows. The policy owner may receive tax free, cumulative of all policies on an insured, the greater of:

- the HIPAA per diem amount established for the period of claim, OR
- actual qualifying long-term care costs incurred.

If long-term care benefits are collected from more than one policy, care should be taken to ensure that part of the benefit does not become taxable. Any LTC benefit amount collected above the defined IRS limits will be taxed as ordinary income. The policy owner may choose to take less than the full maximum monthly benefit amount, which can help prevent a portion of the LTC benefits from becoming taxable as income. However, for maximum efficiency of collecting CareMatters II benefits, please keep in mind that taking a smaller LTC benefit will delay reaching the Extension of Benefits pool, which only pays while the insured is alive and on LTC claim.

Who is responsible for any taxes due on the LTC benefits?
The policy owner is responsible for any taxes due on LTC benefits paid that exceed IRS limits. This is important to remember in circumstances where the policy owner and the insured are not the same person. Nationwide pays LTC benefits to the policy owner.

How is taxation treated when there are multiple LTC policies owned on an insured?
If there are multiple LTC policies in place on one insured, and there are different or numerous policy owners, then the insured — if they are one of the policy owners — will get first rights to the tax-free benefits (per the IRS formula). All other owners will then share in any remaining tax-free amounts or taxes due on a pro-rata basis. If none of the policy owners are the insured, then the tax-free amounts and/or taxable amounts will be shared on a pro-rata basis.

Are LTC benefits tax-free if the policy is a MEC?
Yes. The same provision that determines tax-free LTC benefits will apply even to policies that are a MEC (Modified Endowment Contract). When LTC benefits are being paid via a LTC rider (this applies to all Nationwide LTC products), the LTC benefit is paid as an acceleration of the death benefit. LTC benefits paid from an Extension of Benefits Rider or an Inflation Rider (available only on YourLife CareMatters and CareMatters II) are pure LTC benefits. In either case these benefits remain tax-free per IRS guidelines because they are not withdrawals or loans under the MEC rules.

What happens when the policy is a MEC?
Occasionally a life insurance policy with a LTC rider, and many times a CareMatters or CareMatters II policy will be a MEC (modified endowment contract). This means the policy failed to pass what is known as the 7-pay test.

- **Life insurance with an LTC rider** will most often be a MEC as a result of a single pay or very short premium schedule with new money.
- **YourLife CareMatters** is almost always a MEC due to the structure of the policy
- **CareMatters II** may result in fewer MEC policies due to the structure of the policy. Longer premium schedules — such as pay to attained age 65 and pay to attained age 100 — are also less likely to be MECs.

When a policy has MEC status:

- LTC benefits are received tax free (within IRS limits)
- Death benefits are paid to a beneficiary tax free
- Distributions via loans or withdrawals are taxed last-in first-out to the extent of gains in the policy and may be subject to a pre-age 59 ½ penalty of 10%.

YourLife CareMatters and CareMatters II are not designed as an ideal vehicle to take withdrawals and loans from. If withdrawals and loans are taken, they will have a negative impact on the LTC benefits and death benefit.

STRUCTURE OF CAREMATTERS II AND HOW IT AFFECTS THE GENERAL POLICY

Before moving forward, it helps to understand how Nationwide CareMatters II is structured in regard to how the riders attached to the life insurance policy are paid for. This structure sets CareMatters II apart from many other LTC hybrid and combo products including Nationwide LTC Riders and the original YourLife CareMatters.

CareMatters II is the only Nationwide LTC product that is structured with four separate policy components which are all paid with separately identifiable premiums.

- The base policy is **fixed premium universal life insurance**. It is paid for with a separate identifiable premium.
- **The LTC rider** (which accelerates the specified amount) is paid for with a separate identifiable premium. It is not a charge deducted from cash value and has no impact on the cost basis of the policy.
- **The Extension of Benefits Rider** if chosen, extends LTC benefits once the LTC rider has accelerated the entire specified amount. This rider is paid for with a separate identifiable premium. It is not a charge deducted from cash value and has no impact on the cost basis of the policy.
- The optional **Inflation Benefits Rider** provides the opportunity for the LTC benefit amount to grow over time. This rider is paid for with a separate identifiable premium. It is not a charge deducted from cash value and has no impact on the cost basis of the policy.

No annual 1099-R reporting and no phantom gain with CareMatters II

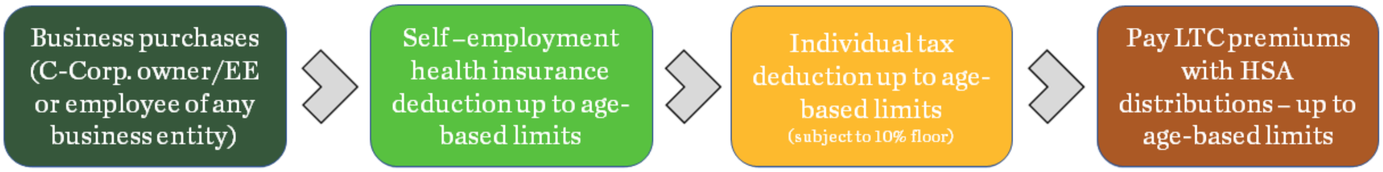
The majority of LTC riders on life insurance and some linked benefit LTC policies pay for LTC policy costs by taking monthly deductions from the cash value. When this is done, it is considered a “non-taxable distribution” from the policy that reduces the cost basis. As long as the policy remains in force, no taxable event will occur. But if the policy is surrendered, a “phantom” gain can result that will be taxed as ordinary income.

Because CareMatters II pays LTC costs with separate identifiable premiums, not as charges deducted from cash value, there are no “non-taxable distributions” to cause a reduction of cost basis. As a result:

- There is no annual 1099-R reporting in relation to the LTC components of the CareMatters II policy
- If a CareMatters II policy is surrendered, there is no 1099-R reporting (phantom) assuming there is neither a) a gain in cash value, or b) a loan balance. LTC premiums paid with HSA dollars or tax deductions taken on LTC premiums paid will be recaptured as income upon surrender of the policy.

Please remember that CareMatters II is the ONLY Nationwide LTC product with separately identifiable LTC premiums. All other Nationwide LTC solutions are subject to the annual 1099-R reporting of charges deducted from cash value to pay for LTC costs.

Hierarchy of tax advantages for purchasing CareMatters II



CORPORATE AND BUSINESS OPPORTUNITIES USING CAREMATTERS II

There is a broader range of tax incentives for business owners purchasing CareMatters II through their business rather than purchasing the policy individually. One advantage is that business owners will get the qualifying deduction as an "above the line" deduction, which is not subject to the 7 ½ % floor required of individual tax payers. The following information will break down these opportunities for business owners of various entities; but first, it may help to understand the value of an "above the line" deduction.

What is the difference between an "Above the Line" deduction and a "Below the Line" deduction?

- Simply put, an "above the line" deduction is a deduction that is taken directly from gross income to help establish the Adjusted Gross Income (AGI)
- Whereas a "below the line" deduction is subtracted from the AGI after it has been established. Since some tax deductions can only be taken upon reaching a "floor percentage" of AGI, the "above the line" deduction is generally considered more valuable to a tax payer.

	Gross Income
Minus	*Above the line deductions (expenses to a business, etc.)*
establishes	**ADJUSTED GROSS INCOME (AGI)**
	ADJUSTED GROSS INCOME (AGI)
Minus	*Standard and itemized deductions (below the line deductions)*
establishes	**Taxable Income**

PROVIDING LTC COVERAGE FOR BUSINESS OWNERS AND EMPLOYEES

Many opportunities exist for a business to offer LTC coverage that will be owned by the owner/employee or non-owner/employees with varying tax advantages. Among these opportunities are:

- Voluntary work site LTC coverage
- Employer funded LTC coverage for employees
- LTC coverage for owner/employees of pass-through entities
- LTC coverage for owner/employees of a C-Corporation
- Company owned LTC coverage for owner/employee or employees

The extent of the tax advantages depends on the type of entity and how it is funded. While the rules for the LTC components of CareMatters II are the same as for traditional LTC policies, the life insurance component of CareMatters II will add some complexity to the tax treatment of the policy.

VOLUNTARY WORK SITE LTC COVERAGE

Employees have the option to purchase LTC coverage through a voluntary plan offered by the employer. This type of coverage offers the least in tax incentives but may offer other advantages, including underwriting concessions and the convenience of having premiums paid through payroll deductions. LTC insurance may not be offered as part of a cafeteria plan under IRC §125(f), therefore the CareMatters II premiums paid for through payroll deduction must come from after-tax dollars.

Fortunately, the LTC premiums are eligible for HSA reimbursement, or, eligible for a potential tax deduction for medical expenses under IRC §213(a). However, to qualify for a medical deduction the taxpayer must reach the 7 ½ % floor of out-of-pocket medical expenses before any tax deductions are realized. If the policy owner does not qualify for the tax deduction but owns an HSA (health savings account), they may request a reimbursement from their HSA administrator for the cost of the LTC premiums up to age-based limits. An individual may take the HSA distribution **or** the tax deduction, but not both. Please remember that only the LTC premiums qualify for these tax advantages, but not the life insurance premium.

EMPLOYER FUNDED LTC COVERAGE — FOR NON-OWNER/EMPLOYEES OF ANY BUSINESS ENTITY OR A LESS THAN 2% OWNER/EMPLOYEE OF AN S-CORP.

There are tax incentives for an employer of any type of business entity that provides LTC coverage to their non-owner employees. These tax incentives also apply to a less than 2% owner/employee of an S-Corporation. The employer can carve out a select group to offer LTC benefits to. When using CareMatters II, the employer can provide long-term care benefits to its employees by implementing employer funded LTC coverage — which qualifies as an accident and health plan under IRC §105(b) and IRC §106(a).

It is important to note that the amount of compensation paying the life insurance premium must be:

- considered ordinary, necessary, and reasonable based on position and services rendered
- paid for actual services provided to the employer

In addition:

- premiums for the life insurance and LTC must be paid in the same year the deduction is taken
- such a policy must be fully owned by the employee
- the employer cannot have any beneficial or ownership rights to the policy

Also, please keep in mind that an employer cannot offer LTC coverage as part of a cafeteria plan (IRC §125 (f)).

How it works

1. The employer will carve out a select group of employees to offer LTC coverage to.
2. The employer will pay all premiums directly to the insurance company to purchase employee owned Nationwide CareMatters II policies for the employees in the group.
3. Compensation used to pay the employee's life insurance premiums will be fully tax deductible by the employer as "an ordinary and necessary business expense".
4. The funds used to pay the life insurance premium will be recognized by the employee as compensation received and will be fully taxable to the employee as ordinary income.
5. The employer – if they wish - can provide additional compensation to the employee to help cover the taxes owed on the compensation that paid for the life insurance portion of the policy.
6. IRC §106 states that when an employer pays the premiums for an employee's qualified LTC coverage, the premiums should be fully deductible to the employer as accident and health insurance.
7. IRC §106 also states that the payments for an accident and health plan (which includes tax-qualified LTC) will not be included in the employee's income.
8. Any LTC benefits the employee receives will also be tax free within IRS guidelines under IRC §7702B(a)(2) and IRC §105(b).

The bottom line for the employer and employee with a CareMatters II policy:

- The life insurance premiums for CareMatters II will be tax deductible to the business as paid compensation and LTC premiums will be deductible to the business as accident and health benefits.

- Only the life insurance premium will be treated as taxable income to the employee; LTC premiums will not be included in taxable income to the employee.
- LTC benefits will be received by the employee tax free subject to IRS guidelines.
- Death benefits to beneficiaries will be received tax free.

Care should be taken when designing the CareMatters II policy premium schedules since the compensation used to pay the life insurance premiums must be considered reasonable by the IRS based on the employee's position and duties performed thus:

- Annual compensation used for paying life insurance premiums to attained age 65 or age 100 should generally not create a challenge, nor should there generally be a problem with a 10-year premium schedule.
- Compensation provided to pay one-time single premiums - and in some cases premiums for 5- year payment schedules - should be looked at carefully to see if they will meet the requirement of reasonable compensation based on services rendered, the position held, and the income level of the employee.

Please note that if the employer funds the LTC premiums of CareMatters II through a flexible spending arrangement, the employee must include the cost of those premiums in gross income per IRC §106(c). In turn, the premiums will be HSA eligible — or — eligible for the IRC §213 medical deduction. The tax deduction will require the individual taxpayer to meet the required 7 ½ % floor of adjusted gross income and the deduction for the LTC premiums will be subject to the age-based limits.

PASS-THROUGH ENTITIES – LTC COVERAGE FOR SELF-EMPLOYED BUSINESS OWNERS

Self-employed individuals may deduct payment of qualified LTC premiums up to the age-based limits shown in the chart below. However, the business owner will qualify for an "above the line" deduction as self-employment health insurance — and will not be subject to the 7 ½ % AGI floor.

These age-based limits will also apply to self-employed business owners who pay qualified LTC premiums for their spouse and dependents. Pleases note that if a self-employed individual or their spouse is eligible to participate in an employer subsidized LTC insurance plan, LTC premiums cannot be deducted as a business expense for any calendar month in which the individual was eligible.

Attained age before end of tax year	2018	2019	2020	2021	2022
40 or under	$420	$420	$430	$450	$450
41-50	$780	$790	$810	$850	$850
51-60	$1,560	$1,580	$1,630	$1,690	$1,690
61-70	$4,160	$4,220	$4,350	$4,520	$4,510*
71+	$5,200	$5,270	$5,430	$5,640	$5,640

* Note the $10 reduction from 2021 numbers

Each type of pass-through entity has slight variations in how LTC premiums should be paid and how they are labeled for purposes of tax advantages.

Sole proprietorships

The sole proprietor can pay for their CareMatters II premium personally and take the age-based deduction for LTC premiums (but not the life insurance premiums) as self-employed health insurance according to IRC §162(i). The tax deduction for the LTC premiums will be treated as an above the line deduction, thus not subject to the 7 ½ % of AGI limitation. The policy must be personally owned, and the business may not have any ownership or beneficial rights to the policy.

Partnership or LLC

A partner of a partnership, or member of a Limited Liability Corporation (LLC) taxed as a partnership can have the partnership purchase CareMatters II for the partners or members. The LTC premiums paid directly by a partnership for the partners may be deductible under IRC §707(c) as "guaranteed payments". Partners are not considered employees, hence IRC §106 will not apply to exclude LTC premiums paid from the partner's income.

The result is that the life insurance premium as well as the LTC premiums will be included in the partner's income. However, the partners are treated as "self-employed" — and thus a partner/member can personally deduct the LTC premium under IRC §162(i) as self-employment health insurance. While the deductible amount will be subject to the age-based limitations, it will be an above the line deduction and therefore not subject to the 7 ½ % floor.

S-Corporation — business owner who is also an employee

LTC benefits for the more than 2% owner/employee -
A more than 2% owner literally owns more than 2% of the business, not just exactly 2%. To be qualified for the tax advantages allowed for an S-Corporation owner, the owner must:

- be a greater than 2% owner on at least one day of the tax year
- and be a bona fide employee of the business

Family attribution rules apply per IRC §318, so any stock owned by a spouse, child, grandchild or parent will be considered in evaluating the requirements for more than 2% ownership.

Ideally, the S-Corporation should have the business pay the CareMatters II premiums. Per IRC §1372, the greater than 2% owner/employee will be treated as a partner in a partnership; thus, LTC premiums for the greater than 2% owner/employee (spouse and dependents) are deductible to the business — up to age-based limits — as self-employment health insurance and may be taken as an above the line deduction. The amount used to pay the premiums for the life insurance component of CareMatters II will be deductible to the business as compensation paid; and also included in the owner's income as compensation received.

If the more than 2% owner/employee pays the LTC premiums personally, then the business will need to formally reimburse the LTC premium portions of the CareMatters II policy to the owner with a written agreement to qualify the deduction as an employer plan on the owner's individual tax return.

A less than 2% shareholder in an S-Corporations would be treated as a non-owner/employee. Please refer back to *"Employer funded LTC coverage for non-owner/employees of any business entity"*.

CareMatters II — Taxation and deductions for pass-through entities			
	S-Corporation	Partnership or LLC	Sole Proprietor
Applies to:	Greater than 2% owner who is also an employee	Partner or member of the partnership or LLC	Sole Proprietor
Policy owner of CareMatters II	Shareholder — must also be an employee	Partner or Member - treated as "self-employed"	Sole Proprietor — treated as "self-employed"
Business tax deduction for CareMatters II premiums	Full deduction for life[i] and LTC portions as employee compensation paid	Full deduction for life[1] and LTC portions as a guaranteed payment	Full deduction for life[1] and LTC portions as employee compensation
Taxation to policy owner	Entire premiums for life and LTC are included as taxable wages	Entire premiums for life and LTC are included in adjustable gross income	Entire premiums for life and LTC are included in adjustable gross income
Tax deduction to policy owner for LTC premiums — above the line deduction	Lesser of premium amount or age-based limit as self-employment health insurance	Lesser of premium amount or age-based limit as self-employment health insurance	Lesser of premium amount or age-based limit as self-employment health insurance
Can business also provide coverage for spouse and dependents?	Yes — under same rules as owner. If also an employee, then employee rules apply	Yes — under same rules as owner	Yes — under same rules as owner.
Will LTC benefits be paid tax-free?	Yes — the greater of: the per diem amount for the claim year or qualified LTC expenses incurred.	Yes — the greater of: the per diem amount for the claim year or qualified LTC expenses incurred.	Yes — the greater of: the per diem amount for the claim year or qualified LTC expenses incurred.
Can business benefit from the policy?	No — the business may not benefit directly or indirectly	No — the business may not benefit directly or indirectly	No — the business may not benefit directly or indirectly

C-CORPORATIONS — BUSINESS OWNER WHO IS ALSO AN EMPLOYEE

The richest tax advantages for business owners is for the owner/employee of a C-Corporation who is buying LTC coverage through the business. The owner must be a bona fide employee — not just a shareholder in the company — and must be paid for actual work that will hold up as "reasonable" in order for the compensation to qualify as a business deduction.

While life insurance and LTC insurance can be offered to selective employees without non-discrimination testing - to avoid premiums being construed as a dividend to the owner, the C-Corporation should "carve out" a group of employees for which LTC benefits will be provided. This group should not be based solely on being a shareholder, but rather, a class of employees eligible to participate in the "employee LTC benefit program" based on factors such as position, length of service, etc. (i.e. officers or senior executives of the corporation).

The C-Corporation will pay all premiums directly to the insurance company to purchase a Nationwide CareMatters II policy for the owner/employee. Please note that the CareMatters II LTC premiums must be paid directly by the corporation and must be 100% at corporate expense. LTC premiums cannot be paid in such a manner that could be construed as a "reduction in salary agreement". And again, LTC insurance may not be offered as part of a cafeteria plan under IRC §125(f).

When an employer uses CareMatters II to provide LTC benefits to an owner/employee, the corporation may deduct the full amount of the LTC premiums paid. Age-based limits do not apply to employer paid LTC coverage for employees or for owner/employees of a C-Corporation. The life insurance premiums will be treated as income to the employee and will be fully deductible as compensation paid. The LTC premiums paid will be tax deductible as accident and health premiums under IRC §106.

In turn, the owner/employee will recognize the amount of the life insurance premiums as ordinary taxable income. The corporation – if they wish - can provide additional compensation to the owner/employee to help cover the taxes owed. In addition, the premiums paid for the LTC portion of the policy will be excluded from the owner/employee's income and LTC benefits will be received tax free within IRS guidelines under IRC §105(b) and IRC §7702B(a)(2).

Non-employee shareholders of a C-Corporation

Should the C-Corporation purchase a CareMatters II policy for a non-employee shareholder, all life insurance premiums and LTC premiums will be included in the income of the shareholder, and none of the policy premiums will be deductible to the corporation.

CareMatters II - Taxation and Deductions for C-Corporation and Employees			
	C-Corp. Owner/employee	**Employee (any entity)**	**< 2% owner/EE of S-Corp**
Owner of CareMatters II	Owner/employee	Employee	< 2% owner/employee
Tax deduction as business expense for premiums paid	Full deduction of life[1] and LTC premium as compensation paid	Full deduction of life[1] and LTC premium as compensation paid	Full deduction for life[1] and LTC premium as compensation paid
Taxation to employee/policy owner[ii]	Life premiums are included as taxable wages. LTC premiums are excluded from income.	Life premiums are included as taxable wages. LTC premiums are excluded.	Life premiums are included as taxable wages. LTC premiums are excluded.
Can spouse and dependents be covered?	Yes, premiums part of EE's compensation as shown above	Yes, premiums part of EE's compensation as shown above	Yes, premiums part of EE's compensation as shown above
Are LTC benefits tax-free?	Yes — per IRS limitations	Yes — per IRS limitations	Yes — per IRS limitations
Can business benefit from the policy?	No — the business may not benefit directly or indirectly	No — the business may not benefit directly or indirectly	No — the business may not benefit directly or indirectly

COMPANY OWNED POLICIES WITH CAREMATTERS II

There are times when a business may want to provide LTC coverage to employees using a CareMatters II policy but maintain rights of policy ownership — particularly in regard to controlling a policy's cash value and naming the business as the death benefit beneficiary. This may be the case whether the insured is an owner/employee or non-owner/employee. In such cases, the specific tax deductions available for the LTC premiums paid by the business will depend on the type of business entity and whether the insured/participant is an owner/employee or non-owner/employee.

The calculation of the tax deduction for LTC premiums of a business owned policy will follow the rules as previously described for each business entity, and whether the insured is an owner/employee or non-owner employee. In addition, there are other Internal Revenue Code (IRC) requirements that must be adhered to:

- When the business owns a CareMatters II policy, the business must comply with the Notice and Consent requirement of IRC §101(j) due to the life insurance component of the policy.
- The business may not take a tax deduction for the life insurance premium when it is the owner of the policy, or a direct or indirect beneficiary of the employee's policy; as premium was not paid with compensation.

- CareMatters II pays cash indemnity LTC benefits directly to the policy owner, which in this case would be the business. LTC benefits will be received by the business income tax free subject to IRS limitations as accident and health benefits.
- The employee will receive LTC payments from the business tax free as an “accident and health benefit” under IR §105(b). Rules for LTC benefits being collected from multiple owners will apply as addressed on page 2 of this paper.
- ERISA requirements and the potential for 409(A) classification must also be considered.

DESIGNING A CAREMATTERS II POLICY FOR ULTIMATE TAX ADVANTAGES

It is important to understand how the LTC premiums play into the total cost of a CareMatters II policy since the way a policy is designed can impact the ratio of life insurance premium vs. LTC premiums as well as maximize the allowable LTC premium deductions for pass-through entities. The two things to consider when designing a CareMatters II policy for business situations is:

- multi-year premium schedules
- adding inflation to the policy

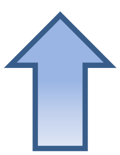
Pass-through entities

Spreading out premium payments over a longer period of time can help owners of pass-through entities better maximize their age-based LTC premium deductions – particularly at younger ages when age-based limits are lower — resulting in less “loss of deductions”. Adding inflation can increase the LTC premium amounts, which may be particularly attractive for owners purchasing coverage at ages of 61 years or older, when age-based limit amounts are much higher.

Employees and C-Corporation owner/employees

For owners of a C-Corporation or for employees receiving LTC coverage from their employer, being able to increase the ratio of LTC premiums vs. life insurance premiums is important in regard to income tax savings - for while LTC premiums will be excluded from the income of an employee or C-Corporation owner/employee, the life insurance premiums will still be included in income and will be taxable.

When breaking down the separate identifiable premiums, please note that in general, the cost of the LTC premiums will go in the following order from most expensive to least expensive:



Inflation rider premium

Extension of benefits premium

LTC rider premium

When comparing a CareMatters II policy with inflation benefits that cost the same as a policy with no inflation — you will see that the policy with inflation has a lower life insurance premium and higher LTC premiums than the policy with no inflation. For example, we will look at a hypothetical situation using the same total premium to compare CareMatters II coverage for a C-Corporation owner/employee. This owner is more interested in the LTC coverage and tax management than in life insurance coverage. Because the life insurance premiums will be included in the owner’s income, designing a policy with inflation can make a significant difference in lowering the life insurance premium amount that will be treated as compensation and included in the owner’s income. The hypothetical policy owner is a 55-year-old male, non-smoker who is married and wishes to purchase a CareMatters II policy with a 6-year LTC benefit period.

By designing the policy with inflation, not only is there more LTC benefits at age 80 than purchasing a policy with no inflation, there is less taxable income created for each of the 5 years premiums are paid for the C-Corp owner/employee due to the shift in balance between death benefit and LTC benefits.

The following chart summarizes the results that can be had by designing a CareMatters II policy with multi-year premiums and adding inflation. The results include:

- inflation that minimizes compensation included in the owner/employee’s income, resulting in a nice income tax savings compared to the same dollar spent on a policy with no inflation
- premiums spread out over time help better justify the compensation as “ordinary and reasonable”
- for pass-through entities, premiums paid over time that can capture more tax deductions

C-Corporation Owner/Employee

55-year-old male, non-tobacco, couples rate paying $20,000 premium for 5 years with a 6-year LTC benefit

	No Inflation	3% Compound Inflation	5% Compound Inflation
$20,000 Premium paid over 5 years	$20,000 X 5 = $100,000 total	20,000 X 5 = $100,000 total	20,000 X 5 + $100,000
Death Benefit	$167,000	$126,000	$100,000
Total LTC benefits policy year 1	$500,000 - $6,945 per mo.	$378,000 - $5,250 per mo.	$313,675 - $3,843
Total LTC benefits at age 80	$500,000 - $6,945 per mo.	$990,000 - $12,700 per mo.	$1,355,000 - $16,600 per mo.
Life insurance premium	$17,736	$13,448	$9,827
LTC Rider premium	$1,006	$763	$558
Extension of Benefits rider	$1,258	$954	$697
Inflation rider	N/A	$4,835	$8,918
Break even age on inflation	N/A	Age 60	Age 63
Annual total deduction to the business[1]	$20,000 (total $100,000)	$20,000 (total $100,000)	$20,000 (total $100,000)
Total annual amount paid that is included in owner/employee's income	$17,736	$13,448	$9,827
Annual for LTC premiums paid by business - but excluded from employee's income	$2,264	$6,552	10,193

Numbers have been rounded for ease of explanation

Of course, planning according to need is every bit as important as the tax advantages.

- Shorter premium schedules will purchase more coverage than longer premium schedules.
- When planning a policy for older applicants - keep in mind that when comparing a policy with inflation to a policy with no inflation that costs exactly the same amount of premium — the "break even" age may be an age that is older than the employee applicant is comfortable with. In such a case, the no inflation option may provide more LTC benefits at an age likely to need LTC.
- One must remember that when considering inflation, the same planned premium will start with less LTC benefits in the early years of the policy than will the same premium paying for a level LTC benefit with no inflation. Should LTC benefits be needed sooner than expected, the result may be less LTC benefits available than the "no inflation" policy would have provided at an age more likely to need care.

When deciding whether to add inflation or not, please consult the "Quick View" in the sales proposal for guidance on the "break even" age.

OTHER THINGS TO CONSIDER

If a business purchases CareMatters II for an employee, and the employee chooses to surrender all of or a portion of the policy, then none of the LTC premiums deducted by the corporation will be considered taxable to the employee - nor will there be a recapture of income to the business- since these premiums were classified as accident and health premiums. The employee already paid tax on the compensation used to pay the life insurance premium.

Businesses can offer LTC benefits as part of a family plan to an employee's spouse and dependents. Should the spouse (and/or dependent) be included in the plan, the cost of the life insurance portion of the policy will be considered part of the employee's compensation. Therefore, care should be taken to plan a premium schedule that will be considered "reasonable compensation" to the employee.

IN SUMMARY

Long-term care coverage is an important part of any retirement plan – and how to buy it is just important to consider.

1. The most tax advantages will be captured by a C-Corporation purchasing LTC coverage for an owner/employee or any business entity purchasing LTC coverage for non-owner employee. The LTC premiums will be 100% deductible.
2. Owners of pass through entities purchasing LTC coverage through their business will qualify for a deduction but only up to age-based limits — however, the deduction can be taken "above the line".
3. Individuals purchasing LTC coverage who itemize may qualify for a deduction of LTC premiums as a medical expense (up to age-based limits) assuming they meet the 7 ½ % floor requirement. This deduction is equal in value compared to using HSA dollars, but if available to be taken it may be wise to use as it will help preserve valuable HSA dollars for years when no medical deduction is available.
4. Using HSA distributions to pay LTC premiums (up to age-based limits) is a valuable option that does not require meeting the 7 ½ % floor.

Business owners have a great opportunity to maximize tax advantages by purchasing LTC coverage for themselves through their business. And for business owners wanting to recruit, reward and retain valuable employees, CareMatters II may be an affordable way to purchase LTC coverage for their employees due to the full deductions of both life insurance1 and LTC premiums. CareMatters II can be a valuable tool in LTC planning for business owners and their employees, providing cash indemnity benefits that will allow the policy owner to maintain choice, control and flexibility when using benefits for their LTC needs.

This material is not a recommendation to buy or sell a financial product or to adopt an investment strategy. Investors should discuss their specific situation with their financial professional.

Federal income tax laws are complex and subject to change. The information in this memorandum is based on current interpretations of the law and is not guaranteed. Neither Nationwide, nor its employees, its agents, brokers or registered representatives give legal or tax advice.

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[i] Please note that life insurance premiums per say are never tax deductible. However, compensation paid by a business to an employee is deductible as an ordinary and necessary business expense. In this circumstance the employee's compensation is being used to pay the life insurance premiums, therefore the compensation is tax deductible.

[ii] Though the employee is the policy owner, they will not be eligible for a personal medical tax deduction under IRC §213(a) nor eligible for an HSA distribution because premiums were paid for by the employer. However, any LTC benefits the employee receives will be tax free within IRS guidelines under IRC §7702B(a)(2) and IRC §105(b).