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What's Going on with HIPAA?

The recent rollercoaster – and why it may not really matter in the long run

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Each year by early November, the IRS establishes a HIPAA per diem rate for the following year that is applied to calculate the tax-free benefit amount that can be received from traditional long-term care (LTC) policies, linked benefit LTC policies, LTC riders on life insurance and annuities, and chronic illness riders. However, the announcement for 2024 proved unusual – the daily HIPAA per diem went down for a second time over its history. Since its inception in 1997, the rate has normally risen each year, with the exception of a few years where it remained the same. This paper will discuss what may have caused the HIPAA per diem to go down again, and why in the big picture it may not make any difference to most people who own cash indemnity LTC coverage.

A CHANGE IN FORMULA BRINGS CHANGES TO THE HIPAA PER DIEM

The Tax Cuts and Jobs Act (TCJA) implemented on January 1, 2018, brought about a change to how fixed dollar amounts, such as the long-term care (LTC) HIPAA per diem, would be indexed for inflation. Prior to 2018, the medical component of the Consumer Price Index for all Urban Consumers (U-CPI-U) was used in calculating the HIPAA per diem each year. This type of formula measures the change in price – and thus the inflation - of a fixed set of products and services.[1]

With the implementation of TCJA, the formula to index for inflation and determine the annual HIPAA per diem now incorporates the Chained Consumer Price Index (C-CPI) - often referred to as "Chained CPI" or "chained weighted inflation". This formula is based on changes in consumer preferences and product substitutions made by consumers due to changes in the price of goods. C-CPI is better suited to measuring the cost of living because it focuses on the actual mix of goods and services consumers purchase - including less expensive substitutions made - but it is a less accurate measure of inflation.[2] While the cost of many items were impacted by high inflation in the last year (such as fuel and food), actual dollars spent on medical care, with the exception of home health care, did not suffer the same impact. In addition, LTC is a just a small percentage of the medical care component of the Consumer Price Index.[3] This explanation is not the whole story – but provides a partial picture for the reduction.

Since the change in formula, there have been a few hiccups in the HIPAA per diem - namely, $10 reductions that happened twice. There has even been talk that this effect on HIPAA could be harmful to policy owners of cash indemnity LTC coverage. But this assumption is basically flawed. Notice that in 2021, the HIPAA per diem increased for the first time by $20, and in 2023 the increase was $30! Over the time, since the inception of HIPAA, the numbers have kept up with inflation to where the current growth equals 3.2% compound! When you consider that 3% compound inflation is the most popular inflation choice for long-term care policies, the HIPAA per diem has kept up with that choice over time.

Historical HIPAA Per Diem Rates since Inception							
1997	$175		**2007**	$260		**2017 - 2018**	$360
1998	$180		**2008**	$270		**2019**	$370
1999 - 2000	$190		**2009**	$280		**2020**	$380
2001	$200		**2010**	$290		**2021**	$400
2002	$210		**2011**	$300		**2022**	$390
2003	$220		**2012**	$310		**2023**	$420
2004	$230		**2013**	$320		**2024**	$410
2005	$240		**2014-2015**	$330			
2006	$250		**2016**	$340			

IRS GUIDELINES FOR TAX FREE LTC BENEFITS

LTC benefits may be received tax free, cumulative of all policies being paid for the benefit of an insured, regardless of who owns the policies, at either: ***the greater of the HIPAA per diem in the year of claim - or - actual qualifying LTC expenses incurred.*** Thus, any amount of LTC benefits received in the year of claim that are equal to or less than the HIPAA per diem will be tax free with no need to justify expenses. *Additionally, any amount received that exceeds the HIPAA per diem but does not exceed actual qualifying expenses, will also be tax free.*[4]

WHY VERY FEW POLICIES WILL BE AFFECTED

When you look at the breakdown of LTC benefit amounts issued, it turns out this is of little concern to most owners of indemnity or cash indemnity LTC coverage. Looking at figures of policy amounts issued from a major insurer of LTC riders on life insurance and linked benefit policies, here is the approximate breakdown: [5]

- 87% of life insurance policies with LTC riders have been issued with LTC benefits less than the 2024 HIPAA limits.
    - With time, some of the remaining 13% of policies will also fall within the HIPAA per diem in the year in which a claim is filed. How many of these LTC rider benefits will eventually fall within the HIPAA per diem is unknown, since the commencement of LTC claims on these policies cannot be predicted.
- 98% of linked benefit policies with no inflation added were issued with LTC benefits below the 2024 HIPAA limit.
- 99.5% of linked benefit policies with inflation were issued below the HIPAA limit amount.
    - Since the HIPAA per diem has increased at 3.2% compound since inception in 1997, policies with 3% simple interest most likely will not exceed the HIPAA per diem in the future, and policies with 3% compound inflation have little chance of exceeding HIPAA based on historical data.
    - The few polices with 5% compound inflation issued near the HIPAA per diem at issue could eventually see LTC benefits exceed the annual per diem. Even so, that leads us to the next point to consider.

CASH INDEMNITY VS. REIMBURSEMENT

There are those who might argue that reimbursement plans are better because LTC benefits are not tied to the HIPAA per diem. But the LTC benefits available for reimbursement under such a plan ***are*** tied to what the contract says is covered. Any LTC expenses not covered under the policy will have to be paid for out-of-pocket.

With cash indemnity benefits, the insurance company places no restrictions on how LTC benefits are used. Therefore, benefits can be used to pay for any type of care as well as for ancillary expenses that would not be covered by a reimbursement plan. More importantly, many of the cash indemnity carriers pay LTC benefits up to 2 times the HIPAA per diem, or place no HIPAA cap on their LTC benefits. This means that policy owners will still have access to LTC benefits that exceed HIPAA if such as amount is available in the policy.

After taking a closer look at the circumstances surrounding the changes in the HIPAA per diem calculations, there is really little to worry about for most owners of cash indemnity LTC coverage. And for the few that have LTC benefits exceeding the HIPAA per diem at claim time, they can still receive LTC benefits tax free simply by limiting the amount of LTC benefits they take from their policy to their qualifying LTC expenses – which will keep benefits received within the IRS tax free limits.[6]

[1] Investopedia – "Chain-Weighted CPI Definition", by Will Kenton; Updated September 02, 2021
[2] Investopedia – "Consumer Price Index for All Urban Consumers (CPI-U)", by Will Kenton; Updated January 15, 2022
[3] U.S. Bureau of Labor Statistics- "Measuring Price Change in the CPI: Medical Care" – August 22, 2023
[4] A tax professional should be consulted to help determine which of the insured's expenditures would be considered a qualifying long-term care expense for purposes of the IRS formula for tax-free benefits.
[5] Actuarial figures from a major insurance company
[6] Supra, Note 4

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