Tax Deductibility of LTC Riders and Linked Benefit Policies

By Shawn Britt, CLU®, CLTC®

Questions often arise about the federal tax deductibility of long-term care (LTC) riders and linked benefit LTC policy costs. Much of the confusion centers around the fact that stand-alone (traditional) LTC policies enjoy a number of tax advantages. Individual taxpayers have the opportunity to choose either a federal tax deduction under IRC §213 as a medical expense, or receive reimbursement from a Health Savings Account (HSA)—both opportunities being subject to IRS limits. There are also attractive tax advantages for business owners when purchasing traditional LTC policies through their businesses. However, the tax advantages afforded to traditional LTC policies do not necessarily carry over to combo or hybrid (linked benefit) LTC policies. Qualification for tax deductions and HSA eligibility depends largely on how the policy is structured.

LTC RIDERS ON LIFE INSURANCE AND ANNUITIES

As of January 1, 2010, the Pension Protection Act 2006 declared that an IRC §213 tax deduction for medical expenses is *not* allowed for the cost of a LTC rider, if the charge for the LTC rider is deducted from the cash value of a life insurance policy or annuity contract. This will apply to certain "combination" LTC products, depending on the product and their structure.

LTC Riders on Life Insurance

Most life insurance policies with LTC riders take the LTC charges from cash value; therefore, these products generally will not qualify for any type of tax deduction or HSA eligibility.

- **Possible Exception: Whole Life Policies with LTC Rider.** Because these policies typically are structured differently in regard to how premiums are received and used to pay policy and rider charges, some LTC riders on whole life policies may qualify for a tax deduction or HSA eligibility. Contact the carrier for clarification.

LTC Riders on Annuities

Nearly all annuities take the charge for the LTC rider from the contract value, thus will *not* qualify for a tax deduction or HSA eligibility.

Linked Benefit LTC Policies

Whether there is eligibility for a tax deduction or HSA reimbursement for the LTC costs varies between carrier versions of this product. Please check with the specific carrier for clarification on deductibility.

- Some products are designed with separate identifiable LTC premiums with no ties to cash value; these LTC premiums may qualify for a tax deduction or HSA eligibility.

- Other policies take LTC charges from cash value and will not qualify for a tax deduction or HSA eligibility.

SEPARATE IDENTIFIABLE LTC PREMIUMS

Policy structure is the key. In order for LTC premiums to be tax deductible or HSA eligible, they must be separate and identifiable. In addition, the LTC premiums must never be linked to the cash value of the policy. Only the life insurance component of the policy can be associated with the cash value.

		Tax Deductible?
Life Insurance (Holds all cash value.)	• Premiums	NO
LTC Premiums (Have no cash value.)	• LTC Rider	YES
	• Extension of Benefits Rider	YES
	• Inflation Rider	YES

In addition, life insurance premiums are not tax deductible as a medical expense, so if an individual taxpayer decides to take a deduction, it would only be for the cumulative total of LTC rider costs (per person if married) up to age-based limits.

Individuals Taking a Medical Deduction vs. an HSA Reimbursement

It always makes good sense to consult a tax advisor on such matters. However in general, the amount of tax savings from claiming a IRC §213 medical tax deduction vs. spending pre-tax HSA dollars for the LTC premium would be similar. Both tax advantages are subject to the same age-based limits. Keep in mind the taxpayer may only choose one tax advantage—they may either deduct their allowable LTC premium, or be reimbursed for the allowable HSA reimbursement.

Individuals who own an HSA account may want to first consider checking to see whether they qualify for a medical tax deduction before taking a reimbursement from their HSA account. The tax deduction is more valuable than an HSA reimbursement by the sheer fact that it preserves HSA dollars for use in a tax year when the taxpayer is unable to qualify for the medical deduction.

Also worth noting is that currently, it may not be easy for individuals to qualify for the medical tax deduction. First, it must make financial sense for the individual taxpayer to itemize deductions; and second, the taxpayer must pay for qualifying medical expenses out-of-pocket in an amount equal to 7 ½% of their Adjusted Gross Income (AGI) before any additional medical expenses (which includes LTC premiums) will qualify as deductible.

Linked Benefit Policies and LTC Tax Advantages for Businesses

LTC tax deductibility rules for businesses vary from those of individual taxpayers. The rules specific to business owners purchasing a policy for themselves and their spouse also vary with the type of business entity. These rules may also apply to the LTC components of certain life insurance based linked benefit policies when structured to qualify for a tax deduction.

C-corporation Owners and Executive Benefits

When LTC coverage classified under IRC §7702B is purchased by a C-corporation for a bona fide owner working in the business, or purchased by any business entity providing employee owned benefits for an employee/executive—100% of the LTC premiums will be deductible to the business as accident and health premiums, and will be excluded from the employee's income. The life insurance premium attached to the policy will also be 100% deductible to the business as compensation (wages) paid, and the employee will pay tax on the life insurance premium amount as income received.

Owners of a Business Classified as a Pass-through Entity

Owners of any pass-through entity will be able to deduct the LTC premiums of the policy, but that deduction will be subject to age-based limits. There is no requirement to itemize deductions, nor is the business owner subject to the 7½% floor of out-of-pocket medical expenses. Rather, the deduction will be taken as some form of self-employment health insurance, making it an "above the line" deduction for the business owner.

What are Age-Based Limits?

These limits are calculated and published each year by the IRS and determine the maximum tax deduction available, or maximum amount allowed as an HSA reimbursement based on age banding. The rates generally go up on an annual basis, however, due to various formula factors used in the calculations and rounding, it is possible on rare occasions that a segment or segments of these numbers will stay the same from one year to the next. Even more rare is for a subset of numbers to go down, but that is what happened for the tax year 2022 for ages 61-70. The reduction was limited to $10. The chart below shows the history over the last five years for IRS age-based limits.

CHRONIC ILLNESS RIDERS... NOT DEDUCTIBLE

Chronic illness riders are a different product. While similar in some respects, it is important to remember they are not long-term care products and:

- They cannot be marketed or spoken of as long-term care coverage
- They are not required to and usually do not offer the comprehensive consumer protections required of IRC §7702B long-term care coverage.
- They are not tax deductible or HSA eligible

Chronic illness riders are classified solely under IRC §101(g) for determining any tax advantages. While this allows for chronic illness rider benefits to be tax-free up to IRS guidelines, none of the costs for a chronic illness rider qualify for a tax deduction, nor are they qualified for HSA reimbursement.

IRS AGE-BASED LIMITS

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

TAX DEDUCTIBILITY POTENTIAL

A General Summary for the Potential to Deduct LTC Premiums

LTC Stand-Alone Policy *(individually owned)*	**YES**, within IRS limitations.
LTC Stand-Alone Policy *(paid for by a business or corp.)*	**YES**. Rules and amount will vary based on the type of business entity and particular circumstances.
Life Insurance-based Linked Benefit LTC Policies	**YES**, when LTC components of the policy are paid for with separate identifiable premium (not from cash value). When qualified, tax advantages for the cumulative total of LTC premiums follow the same rules as traditional LTC premiums (whether paid for by an individual or paid for by a business). Please check with the carrier regarding policy structure and whether qualified for LTC tax deductions.
LTC Rider on Life Insurance	**NO** (generally), when the cost of the rider is paid from cash value deductions, which applies to most policies, except some whole life policies. Please check with the carrier.
LTC Rider on Annuities	**NO.**
Chronic Illness Rider on Life Insurance	**NO.**

FINAL THOUGHTS

Even when LTC premiums can be listed on a tax return as an IRC §213 tax deduction, it will be difficult for many individual taxpayers to reach the requirements needed to realize the deduction. Medical expenses must generally be higher in a year when income is lower. For people with HSA accounts, reimbursements (up to age-base limits) for LTC premiums paid will be available for products that qualify. Business owners will have greater latitude in capturing tax deductions. However, the bottom line is that one should choose the LTC solution that meets the care needs they envision in the future, not because there might be a tax deduction.

SHAWN BRITT
CLU®, CLTC®

Shawn is Director of LTC Initiatives for Advanced Consulting Group at Nationwide Financial. She has been engaged in the life insurance and LTC industry for over 20 years. Shawn has been a major influence in promoting the need for long-term care and development of Nationwide's LTC product solutions.