

MetLife[®]

Long-Term Care Insurance

Guide
to Current
Federal Taxation

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- Not FDIC Insured
- Not Insured by Any Federal Government Agency
- Not Issued, Guaranteed or Underwritten by Bank or FDIC
- Not a Condition to the Provision or Term of any Banking Service or Activity
- Policy is an Obligation of the Issuing Insurance Company

When The Health Insurance Portability and Accountability Act of 1996 (HIPAA) was signed into law on August 2, 1996, it introduced and defined TQ Long-Term Care Insurance.

Naturally, since HIPAA changed how long-term care insurance premiums and benefits are treated under current tax laws, many questions have arisen. Therefore, MetLife is pleased to provide this *Long-Term Care Insurance Guide to Federal Taxation*.

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 legislative change and judicial and administrative interpretation. We are not authorized to practice law or to provide legal, accounting or tax advice. Before considering the application of this information to your own situation, you should consult your legal or tax advisor.

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Tax Qualified Long-Term Care Insurance Policy Requirements

A Tax Qualified (TQ) Long-Term Care Insurance (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.

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 which 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 (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.

TQ Long-Term Care Insurance Policy Definitions

- **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.

Federal Tax Legislation Overview

- For Federal income tax purposes, a TQ Long-Term Care Insurance policy is generally classified as Accident and Health Insurance.¹
- Benefits received from a TQ Long-Term Care Insurance policy are not generally taxable as income.²
- Eligible premiums paid on TQ Long-Term Care Insurance 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).³

Please refer to the current year Tax Supplement for eligible premiums.

- Employer-paid TQ Long-Term Care Insurance premiums for employees may be tax deductible to the employer.⁴
- Employer- paid TQ Long-Term Care Insurance premiums, on behalf of an employee, are not included as income to the employee.⁵
- Benefits received from an employer-paid TQ Long-Term Care Insurance policy are not generally taxable to the employee.⁶
- 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 long-term care insurance 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.⁷

¹ IRC §7702B (a) (3)

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

⁶ IRC §105(b), IRC §7702B(a)(2), IRC §7702B(d), IRC §213(d)(1)

⁷ Treasury Reg. 1.7702B-2

Tax Treatment of TQ Long-Term Care Insurance Policy Benefits

In general, if you receive benefits under a TQ Long-Term Care Insurance policy (other than dividends or premium refunds), your benefits are excluded from income the same as benefits received for personal injuries and sickness.⁸

As such, benefits are treated as reimbursement for actual medical expenses incurred, regardless of whether your Long-Term Care Insurance policy reimburses actual expenses or pays benefits on a per-diem or other periodic basis.

- Long-term care insurance benefits paid under a TQ Long-Term Care Insurance policy on a reimbursement basis are generally tax-free. Under a reimbursement basis, your policy pays for actual long-term care charges incurred, up to the daily benefit you selected.
- Benefits paid on a per-diem or other periodic basis under a TQ Long-Term Care Insurance 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.

Please refer to the current year Tax Supplement for per-diem limits.

⁸IRC §7702B(a)(2), 104(a)(3), 105(b)

Tax Treatment of TQ Long-Term Care Insurance Policy Benefits *(continued)*

EXAMPLE: 2006 TQ LTCI Policy Benefit Taxation

- Benefits paid on a per-diem or other periodic basis under a TQ LTCI policy.
- Mary, age 84, has a MetLife TQ LTCI Policy with a per-diem Daily Benefit Amount (DBA) of \$280.
- Mary becomes Chronically Ill and receives Home Care Services at a cost of \$200 per day.
- MetLife pays Mary a per-diem benefit of \$280 per day, which is **\$80** in excess of the cost of Mary's long-term care services, and **\$30** in excess of the annual per-diem limit for 2006 of \$250 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 tax liability.* Mary's tax liability is the DBA less the per-diem limit. Accordingly, **\$30** of the excess payment would be taxable income to Mary ($\$280 - \$250 = \$30$).

*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 TQ Long-Term Care Insurance (LTCI) Premiums

Tax Treatment of Individual Taxpayer's Premiums

Individuals can now include as itemized medical expenses, TQ LTCI premiums paid in a calendar year subject to age-based premium limitations, which are adjusted annually.⁹

Total itemized medical expenses that exceed 7.5% of Adjusted Gross Income (AGI) are deductible. The deductible portion of the TQ LTCI premium allowed, subject to the 7.5% AGI threshold, is referred to as the “eligible long-term care insurance premium”.¹⁰

Please refer to the current year Tax Supplement for eligible premiums.

The individual must have a TQ LTCI policy and itemize his/her expenses on a Form 1040 Schedule A. Some states may allow a greater deduction to TQ LTCI premiums in computing state income tax.

EXAMPLE: 2006 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
- 2006 TQ maximum age based “eligible LTCI premium” = \$1,060

Calculations:

- \$70,000 (AGI) x 7.5% = \$5,250
- \$3,000 + \$1,060* = \$4,060 - \$5,250 = (\$1,190)
- \$0 = Total Medical Expense Deduction

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

⁹IRC §213(d)(1)(D)

¹⁰IRC §213(d)(1)(D)

Employer-Paid TQ Long-Term Care Insurance Premiums

Business Owners can offer Long-Term Care Insurance to all employees or to selected employees only. There are no highly compensated nondiscrimination rules that apply to TQ Long-Term Care Insurance policies.

In order to be deductible to the business, the TQ Long-Term Care Insurance premiums must be reasonable compensation for personal services rendered within the meaning of IRC Sec. 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 Long-Term Care Insurance policy premiums are excluded from an employee's gross income because TQ Long-Term Care Insurance is treated as Accident and Health Insurance for tax purposes.¹¹ This exclusion does not apply, however, if the Long-Term Care Insurance is offered through a cafeteria plan. As a result, Long-Term Care Insurance premiums and expenses are not considered tax-free under a flexible spending account.

TQ LTCI Benefits received 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 example on page 6)

¹¹IRC §7702B(a)(3)

Employer-paid TQ Long-Term Care Insurance Premiums *(continued)*

C-Corporation

When a C-Corporation pays the premium on TQ Long-Term Care Insurance policies for bonafide employees, their spouses and their dependents, the C-Corporation generally can deduct 100% of the premium as a reasonable business expense, regardless if the employee has ownership in the business.¹²

C-Corporation owners are treated like any other employee.

However, if a C-Corporation purchases a TQ Long-Term Care Insurance policy for a shareholder who is NOT an employee, no deduction is available to the C-Corporation and the premiums represent dividend income to the shareholder.

Tax Treatment of the Self-Employed

Self-Employed includes:

- Sole-Proprietor
- Partner in a Partnership (including LLC treated as a Partnership for tax purposes)
- S-Corporation Shareholder owning more than 2% of Corporation (including PC and PSC treated as an S-Corporation for tax purposes)

¹²IRC §7702B(a)(3) 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.

Note: LLC - Limited Liability Corporation
PC - Professional Corporation
PSC - Personal Services Corporation

Employer-Paid TQ Long-Term Care Insurance Premiums *(continued)*

Sole-Proprietor:

The owners of these entities can deduct 100% of the maximum “eligible TQ long-term care insurance premiums” paid on their behalf, including premiums paid for their spouses and dependents, for TQ LTCI policies.¹³

Please refer to current year Tax Supplement for eligible premiums.

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.

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.¹⁴

Sole-Proprietor Tax Deduction Example:

James, age 51, a self-employed plumber has a TQ LTCI Policy.

- James Annual TQ LTCI Premium = \$1,700
- 2006 “eligible LTCI premium” = \$1,060
- \$1,060* 2006 Tax Deduction (\$1,060 x 100%)

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

¹³IRC §162(1), 213(d), 162(1)(2)(C)

¹⁴IRC §7702B(a)(3)

Employer-Paid TQ Long-Term Care Insurance Premiums *(continued)*

Partnerships (including LLCs):

If a Partnership purchases a TQ Long-Term Care Insurance policy for partners for services rendered by the partners (not based on income to the partner), and/or for non-partner employees, the Partnership may deduct the full premium amount as a reasonable and necessary business expense. A partner's and/or employee's spouse and/or dependent would also be eligible for this treatment.¹⁵

If the Partnership purchases a TQ Long-Term Care Insurance policy for 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.¹⁶

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 below.

¹⁵IRC §7702B(a)(3)

¹⁶IRC §162(1), 213(d), 162(1)(2)(C)

Employer-Paid TQ Long-Term Care Insurance Premiums *(continued)*

Partners Personal 2006 Tax Deduction Example:

- Mary, Age 45
 - TQ LTCI Premium = \$1,600
 - 2006 “eligible LTCI premium” = \$530
 - \$530* Personal Tax Deduction (100% x \$530)
 - Total Premium of \$1,600 reported as income

- Joan, Age 51
 - TQ LTCI Premium = \$2,500
 - 2006 “eligible LTCI premium” = \$1,060
 - \$1,060* Personal Tax Deduction (\$1,060 x 100%)
 - Total Premium of \$2,500 reported as income

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

S-Corporation:

TQ Long-Term Care Insurance premiums paid by an S-Corporation on behalf of owners of 2% or more of stock and/or employees are tax deductible as a reasonable and necessary business expense. An owner’s and/or employee’s spouse and/or dependents would also be eligible for this treatment. Also, owners of 2% or more of stock are generally treated as partners. (see above)¹⁷

¹⁷IRC §7702B(a)(3)

Employer-Paid TQ Long-Term Care Insurance Premiums *(continued)*

S-Corporation Tax Deduction Example:

Bob, age 68, and Sue, age 65, 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.

- TQ LTCI Annual Premiums paid by the business
 - Bob = \$5,800
 - Sue = \$4,300
- Subchapter S-Corporation Tax Deduction = \$10,100 – Total premiums paid for Bob and Sue

The premiums paid are reported as income to each owner equal to premium paid by the Sub-S-Corporation.

Owners Personal Tax Deduction Example:

- Bob, Age 68
 - TQ LTCI Premium = \$5,800
 - 2006 “eligible” LTCI premium = \$2,830
 - \$2,830* Personal Tax Deduction (100% x \$2,830)
 - Total Premium of \$5,800 reported as income
- Sue, Age 65
 - TQ LTCI Premium = \$4,300
 - 2006 “eligible LTCI premium” = \$2,830
 - \$2,830* Personal Tax Deduction (\$2,830 x 100%)
 - Total Premium of \$4,300 reported as income

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

The following are the most commonly asked questions pertaining to Long-Term Care Insurance Taxation.

Question #1

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

Question #2

- Q. What are the tax consequences if a C-Corporation pays the LTCI premium for a non-employee Board of Director Member?
- A. 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.

Question #3

- Q. Can a Tax-Exempt Organization (501(c)) pay for its employees and their spouses/dependents TQ LTCI premium?
- A. Yes, however there would only be a tax deduction to the extent the organization has taxable income, i.e., unrelated business income and the payments are directly connected to such income.

Question #4

- Q. Can an employer pay the TQ LTCI premium for an employee's domestic partner and receive a tax deduction?
- A. Only if the domestic partner can qualify as a dependent of the employee under IRC §152.

Question #5

- Q. If the domestic partner is not a dependent of an employee and the employer pays the domestic partner's TQ LTCI premium what are the tax consequences?
- A. The premium would be included in the employee's gross income and the employer would get a tax deduction for wages paid.

Question #6

- Q. Can TQ LTCI premiums be paid from a Flexible Spending Account (FSA)?
- A. No, FSA amounts may not be used to pay for LTCI. LTCI premiums are not a "qualified benefit" under a FSA.

Question #7

- Q. What is a Health Spending Account (HSA)?
- A. A 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. A 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 (including LTC expenses and LTCI premiums) are not taxable.

Please note that this is a very brief summary of complex rules that govern HSAs.

Question #8

- Q. Can TQ LTCI be offered as part of a Cafeteria (IRC §125) Plan?
- A. No, however, LTCI premiums may be paid through a Health Savings Account (HSA), which can be included in a Cafeteria Plan.¹⁸

Question #9

- Q. Is the premium refunded to the insured's estate at death under MetLife's Return of Premium Rider taxable?
- A. Yes, refunds of premium are subject to estate tax regardless of who paid the premium and may be taxable. The Estate pays income tax to the extent of the amount tax deducted by the insured/decedent from prior premiums paid. The Estate pays income tax on entire premium if originally paid by the insured's/decedent's employer.

Question #10

- Q. Is the amount of premium refunded to the insured's individual beneficiary at death under MetLife's Return of Premium Rider taxable?
- A. Yes, returns of premium may be taxable income 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. The beneficiary pays income tax on the entire premium refunded if originally paid by the insured's/decedent's employer.

¹⁸IRC Notice 2004-50, 2004-33

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