

## Accelerated Premium Payment/Limited Pay Plans

### General Rule

#### For the Employer

A business that purchases TQ LTCI on behalf of an Employee may deduct the premiums paid as an ordinary business expense. The same should hold for Accelerated Payment plans such as 5 Pays, 10 Pays, Pay to Age 65 and other Limited Pay plans provided that: the accelerated premium amount can be considered as reasonable compensation for the level of the employee.

#### For the Employee

The accelerated LTCI premiums paid by the Employer would be excludable from income under IRC Sec. 106. Similarly, any benefit payments received under the policy would be excludable from income under IRC Sec. 105.

### Boards of Directors

Many times, a business may choose to purchase LTCI on behalf of the members of the business's Board of Directors. This can have varying tax implications.

### Board Members

Members of the Board of Directors are considered to be Independent Contractors and not employees of the business itself. As such, any LTCI purchased by the business on behalf of the Board Member would be considered to be taxable compensation for the Board Member.

The result is that the LTCI policy is essentially purchased by the Board Member with after-tax dollars and as such, the Board Member would be entitled to any tax advantage he or she might otherwise have (Individual Taxpayer, Self-Employed, etc.). The business has the ability to deduct the premium as an ordinary business expense as reasonable compensation. The result should be the same for the Board Member regardless whether the employer is a for-profit or not-for-profit organization. The following table applies to deductibility of long term care insurance premium for self-employed.

### 2006 Table of Eligible Deductible Premium

Age	Eligible Premium 2006 Limit	Eligible Premium 2005 Limit	Eligible Premium 2004 Limit
< 40	\$ 280	\$ 270	\$ 260
41-50	\$ 530	\$ 510	\$ 490
51-60	\$1,060	\$1,020	\$ 980
61-70	\$2,830	\$2,720	\$2,600
70 >	\$3,530	\$3,400	\$3,250

## **Combination Board Member/Employee**

In some situations, the Board Member may also be an employee of the business. Provided that the business clearly purchases the LTCI policy as part of the Board Member/Employee **employee compensation**, the premiums would not be considered taxable compensation for the Board Member/Employee.

## **Combination Board Member/Shareholder**

TQ LTCI premium paid by the business on behalf of a Board Member/Shareholder will likely be taxable compensation for the Board Member/Shareholder either as taxable compensation for Board Member services rendered or as dividend payment to a shareholder. How the premium is categorized could have tax ramifications for both the Board Member/Shareholder and the Business.

## **Cafeteria Plans**

Section 125(f) of the Tax Code specifically excludes “any product which is advertised, marketed, or offered as long-term care insurance” from any Cafeteria Plan.

## **COBRA**

Long-term care insurance is expressly excluded from COBRA coverage continuation requirements. Section 4980B(g)(2) of the Tax Code states that COBRA does not include “any plan substantially all of the coverage under which is for qualified long-term care services (as defined in section 7702B(c)).”

## **Discrimination**

Discrimination is the process by which an employer may select particular employees for which LTCI policies will be purchased, thereby including some employees and excluding others.

The tax code does not expressly address whether it is permissible to discriminate or upon what criteria an employer may choose to discriminate in purchasing LTCI for selected employees.

Some have suggested that because the tax code is silent with regards to discrimination, then discrimination is impliedly endorsed or (at the very least) permitted.

The argument advanced suggests that because Congress took great pains to omit LTCI from some requirements (i.e. Cafeteria Plans and COBRA), Congress approved of Discrimination by not disallowing it.

## **ERISA**

Employer-paid TQ LTCI may be covered under ERISA (the Employer Retirement Income Security Act of 1974).

## **FSAs**

Section 106(c)(1) expressly states that employer-paid TQ LTCI provided through a Flexible Spending Account is included in the employee's gross income.

## **Grandfathered LTCI**

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) provided that any LTCI contract issued prior to January 1, 1997, which met the TQ LTCI requirements of the state in which the policy was issued, would be treated as a TQ LTCI contract. As a result, services provided and benefits received under these policies would be treated as TQ LTCI services and benefits.

Materially altering a grandfathered LTCI policy could jeopardize the grandfathered status and result in the issuance of a "new contract" thereby forfeiting any beneficial treatment the policy owner may have enjoyed with the original, grandfathered policy.

## **Not-for-Profit Organizations**

Not-for-profit (Section 501(c)) organizations are treated similarly to C-Corporations for purpose of establishing employee health plans, including LTCI. As such, the tax rules for C-Corporations would generally apply to not-for-profit organizations.

## **Return of Premium upon Death Riders**

### **General Rule**

It is accepted that the tax code permits the inclusion of a Return of Premium Upon Death Rider on TQ LTCI policies ((Sec. 7702B(b)(2)(C) – refund of premium upon death recognized providing the refund does not exceed the aggregate premiums paid under the contract). Providing that the refund does not exceed the aggregate premiums paid under the contract, the refund is generally not included in the gross income of the beneficiary.

### **Employer-Purchased LTCI**

One strategy some Employers attempt is to purchase LTCI with a Return of Premium Rider (ROP) on behalf of an Employee. The Employer then retains ownership of the policy, the Employee is the insured, and the Employer lists the business as the beneficiary of the ROP. The Employer attempts to deduct the premium payments as a reasonable business expense and then, should the Employee die, attempts to collect the benefits of

the ROP as a non-taxable event. With this strategy, the Employer runs the risk of jeopardizing its deduction for the premium, and the refund may be includable in the employer's gross income. It is likely that either the Employer could deduct the premiums as a business expense or receive the ROP benefits tax-free upon the Employee's death, but not both.