

Employer-provided long-term care insurance for C corporations

By Edward S. Hutman, CLTC

The Health Insurance Portability and Accountability Act (HIPAA) of 1996 addressed long-term care insurance (LTCI). The new HIPAA rules, together with regulations promulgated by the Department of the Treasury, have created a favorable framework for the tax treatment of long-term care insurance premiums.

The following is a summary of regulations affecting the treatment of a LTCI qualified under HIPAA:

- Any plan of an employer providing coverage under a qualified LTCI contract shall be treated as an accident and health plan with respect to such coverage. IRC § 7702B(a)(3)
 - No non-discrimination requirements. Treas. Regs. §§ 1.105-5, 1.106-1
 - Premiums are deductible by employer. IRC § 162(a)
 - Premiums are not included in employee's income. IRC § 106(a)
 - Income tax-free benefits. IRC § 105(b)
 - Can cover employee, spouse and dependents. IRC §§ 105, 106
 - The stockholder / employee is treated as an employee if the plan for employer-provided coverage is not based on stockholder status but on employee status. IRC § 105(b) IRC § 106(a)
 - An employer-paid LTCI may not be paid through flexible spending or similar arrangements. IRC § 106(c)
 - Long-term care premiums may not be paid through a cafeteria plan. IRC § 125(f)

Example

The following scenario illustrates the unique tax advantages given to LTCI in a C corporation environment.

- ABC, Inc., is a C corporation. It buys a tax-qualified LTCI policy for Joe, a 55-year-old employee. The goal is to achieve a total potential benefit by age 85 that exceeds \$2 million. The annual premium is \$2,500.
- ABC, Inc., may deduct the full premium \$2,500¹.
- Joe does not have to include the \$2,500 premium in his income.

• If Joe receives benefits from the policy, he does not have to include the benefit amount in his income.²

• ABC, Inc. is not required to pay premiums for employees not in Joe's employee category or class.

The above holds true if Joe owned 100 percent of the shares of the corporation. The premiums for Joe's wife will also be treated in the same way. In addition, the above would apply even if ABC, Inc., employed 50 people and Joe and his wife were the only employees for whom ABC, Inc., paid the LTCI premium.

An additional note: All of the above statements apply in an S corporation environment for stockholder-employees owning 2 percent or less of the outstanding stock. An S corporation stockholder-employee who owns more than 2 percent of the outstanding stock will be treated like a partner, not an employee, and premiums paid by the corporation are treated as guaranteed payments and must be included in income. The greater-than-2 percent stockholder-employee may deduct the actual premiums up to the limit shown in the age-based schedule under IRC Sec. 162 (l). Rev. Rul. 91-26, 1991-1 C.B. 184. This schedule is adjusted on an annual basis.

A cautionary note: An accident and health plan must provide benefits for stockholder-employees as an incident of the employment relationship. The role of stockholder-employees should be clearly stated in the corporate resolution adopting the LTCI plan.

Some thoughts for your clients:

Within a C corporation setting, the employer has available a number of alternative approaches to provide employees with a long-term care insurance benefit that is affordable and effective.

- An employer can provide a long-term care insurance benefit to a specific executive or a select group of executives. This plan can cover not only the executive but also the executive's spouse and dependents.
- An employer can reward loyalty to the company by providing long-term care insur-

ance coverage to employees who, for example, have worked for the company for at least 10 years.

• Group long-term care insurance programs can be created on a fully voluntary basis or as part of a layered benefit program for a defined employee group as a stand-alone program or within the same broader plan which includes full or partial company premium payments for executives or defined employees.

• Long-term care insurance programs can be created in which the employer pays a part of the premium and employees "buy up" to desired benefit levels. This split can be based on any of the following policy structures:

1. Percentage (i.e. employer pays 10 percent, employee pays 90 percent)
2. Benefit split (i.e. employer pays base benefit of \$50 per day, employee pays for \$100 per day, for a total benefit of \$150 per day)
3. Elimination period split (i.e. employer pays for a 90-day elimination period, or waiting period, and employee pays to lower the elimination period to 30 days)
4. Benefit period split (i.e. employer pays for a two-year benefit period and employee "buys up" to six years by paying the difference in premiums)

Qualified long-term care insurance enjoys several advantages as a result of HIPAA and the regulations pertaining to health care coverage and long-term care insurance. To plan effectively, financial advisors and their clients must understand the tax implications of this coverage under different scenarios.

¹ Annual premium for \$200 per day, six-year benefit period, 5 percent compound inflation, 90-day elimination period, 100 percent home health care, with group discount.

² This applies to reimbursement policies. If an indemnity contract pays a per diem benefit that exceeds the per diem limit provided under IRC § 7702B(d) (\$250 in 2006), the excess is taxable income to the extent it exceeds actual long term care expenses.

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