The information contained in this presentation is not written or intended to be interpreted as specific legal or tax advice and may not be relied on for purposes of avoiding any federal tax penalties.

Neither MassMutual nor any of its employees or representatives are authorized to give legal or tax advice. Individuals are encouraged to seek the guidance of their own legal or tax counsel.

Any individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.
Agenda

- LTCi Tax Basics (slide 4)
- Medical Expense Deduction (slide 9)
- Health Savings Accounts (HSAs) (slide 13)
- Medical Care Gift Tax Exclusion (slide 17)
- Trust Owned LTCi (slide 21)
- Employer-Provided LTCi (slide 26)
- Self-Employed Health Insurance Deduction (slide 41)
Qualified LTCi
IRC § 7702B(b)

- Only insurance protection is coverage of qualified LTC services
- Guaranteed renewable
- No cash surrender value or any money that can be paid, assigned, pledged or borrowed
- Refunds and dividends (other than refunds upon termination of policy or at death) used to reduce future premiums or increase future benefits
- Cannot pay for expenses reimbursable under Medicare
- Must meet certain consumer protection provisions
Qualified LTC Services
IRC § 7702B(c)

- Necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services required for chronically ill

- Chronically ill individual
  - Certified by licensed health care practitioner
  - Unable to perform 2 of 6 ADLs for 90 days
  - Severe cognitive impairment
Qualified LTCi contract shall be treated as an accident & health insurance contract. IRC § 7702B(a)(1)

- *Eligible* LTC premium for each person covered is “medical care.” IRC § 213(d)(1)(D)

- Reimbursement benefits not included in income. IRC §§ 104(a)(3), 7702B(a)(2)

- Per diem or indemnity benefits not included in income except those amounts exceeding the greater of
  - *Total qualified LTC expenses, or*
  - $320 per day (in 2013).

IRC §§ 104(a)(3), 7702B(a)(2), 7702B(d)
Eligible LTC premiums in 2013:

<table>
<thead>
<tr>
<th>Attained Age</th>
<th>Limitation on Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age 40 or less</td>
<td>$360</td>
</tr>
<tr>
<td>Age 41 – 50</td>
<td>$680</td>
</tr>
<tr>
<td>Age 51 – 60</td>
<td>$1,360</td>
</tr>
<tr>
<td>Age 61 – 70</td>
<td>$3,640</td>
</tr>
<tr>
<td>Age 71 and older</td>
<td>$4,550</td>
</tr>
</tbody>
</table>

Rev. Proc. 2012-41
Refund of Premium or Full Nonforfeiture Rider

“Any refund on a complete surrender or cancellation of the contract shall be includible in gross income to the extent that any deduction or exclusion was allowable with respect to the premiums.”

IRC § 7702B(b)(2)(C)
Medical Expense Deduction
IRC § 213(a)

- Eligible" premiums deductible as unreimbursed medical expense
  - Subject to 10% of AGI threshold*
  - IRC §§ 213(a), 213(d)(1)(D)

LTC benefits income tax free
- IRC § 104(a)(3)

*The 7.5% AGI threshold may be used through 2016 for any calendar year that either the taxpayer or the taxpayer’s spouse has attained age 65 before the close of the year. IRC § 213(f).
Medical Expense Deduction
IRC § 213(a)

- Expenses paid for medical care of taxpayer, spouse or dependent
- Taxpayer must itemize deductions (IRS Form 1040, Schedule A)
- Deductible to extent that such expenses (including payment of eligible LTC premium) exceed 10% of AGI*

*The 7.5% AGI threshold may be used through 2016 for any calendar year that either the taxpayer or the taxpayer’s spouse has attained age 65 before the close of the year. IRC § 213(f).
Ed (age 61) & Ann (age 59) Dunn
LTCi premium = $5,700

2013 IRS Form 1040
Adjusted Gross Income $75,000
- Ed’s eligible LTC premium 3,640
- Ann’s eligible LTC premium 1,360
- Other medical expenses 4,500
- Total medical expenses 9,500
- 10% of $75,000 (7,500)
- Medical Expense Deduction (2,000)
- Taxable Income $73,000
Medical Expense Deduction
IRC § 213(a)

Ed (age 61) & Ann (age 59) Dunn
LTCi premium = $5,700

2013 IRS Form 1040
Adjusted Gross Income $75,000

   Ed’s eligible LTC premium 3,640
   Ann’s eligible LTC premium 1,360
   Other medical expenses 580
   Total medical expenses 5,580
   10% of $75,000 (7,500)

Medical Expense Deduction 0
Taxable Income $75,000

For Producer And Professional Advisor Use Only.
Not For Use With The Public.
Health Savings Accounts (HSAs)

Basics

- Personal health care savings vehicle
- Individuals under age 65 and covered by high deductible health plan (HDHP)
- Contributions tax deductible (above-the-line)
- Distributions for qualified medical expenses tax free
- Distributions for other purposes
  - Includible in gross income
  - Subject to 20% penalty under age 65
2013

<table>
<thead>
<tr>
<th></th>
<th>Individual</th>
<th>Family</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Deductible Health Plan:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Minimum deductible</td>
<td>$1,250</td>
<td>$2,500</td>
</tr>
<tr>
<td>Maximum out-of-pocket</td>
<td>$6,250</td>
<td>$12,500</td>
</tr>
<tr>
<td>Contribution Limit:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum aggregate annual</td>
<td>$3,250</td>
<td>$6,450</td>
</tr>
<tr>
<td>“Catch-up” for 55-64</td>
<td>$1,000</td>
<td>$2,000 *</td>
</tr>
</tbody>
</table>

*If both spouses are between 55 – 64.
Health Savings Accounts (HSAs)  
IRC § 223

- “The term ‘health savings account’ means … for the purpose of paying the qualified medical expenses of the account beneficiary ….”
  - IRC § 223(d)(1)
- “The term ‘qualified medical expenses’ means … amounts paid … for medical care (as defined in section 213(d)) ….”
  - IRC § 223(d)(2)(A)
- “Health insurance may not be purchased ….”
  - IRC § 223(d)(2)(B)
- Except coverage under qualified LTCi
  - IRC § 223(d)(2)(C)(ii)
HSA offered under cafeteria plan can pay for LTCi
- IRC § 125(f) not applicable because HSA and not LTCi offered under cafeteria plan

Only eligible LTC premium can be paid from HSA
- Excess premium reimbursements includible in gross income and may be subject to 10% penalty

Salary-reduction contributions to HSA not flexible spending or similar arrangement
- IRC § 106(c) not applicable because HSA is personal health care savings vehicle
“Any qualified transfer shall not be treated as a transfer of property by gift for purposes of this chapter.”

IRC § 2503(e)(1)

“… the term ‘qualified transfer’ means amounts paid on behalf of an individual to any person who provides medical care (as defined in section 213(d)) with respect to such individual as payment for such medical care.”

IRC § 2503(e)(2)(B)
“… the exclusion from the gift tax includes amounts paid for medical insurance on behalf of any individual….”

Reg. § 25.2503-6

“… amounts paid for a qualified long-term care insurance contract … shall be treated as payments made for insurance for purposes of section 213(d)(1)(D) ….”

IRC § 7702B(a)(4)
“The term ‘medical care’ means amounts paid … for any qualified long-term care insurance contract ….
“In the case of a qualified long-term care insurance contract … only eligible long-term care premiums … shall be taken into account ….”

IRC § 213(d)(1)(D)
Carol wants to provide LTCi for her mother, Dorothy, age 69. LTCi premium = $4,000

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gift amount</td>
<td>$4,000</td>
</tr>
<tr>
<td>Medical care gift tax exclusion</td>
<td>3,640</td>
</tr>
<tr>
<td>Annual gift tax exclusion</td>
<td>360</td>
</tr>
<tr>
<td>Taxable gift</td>
<td>0</td>
</tr>
<tr>
<td>Carol’s remaining annual gift tax exclusion</td>
<td>$13,640</td>
</tr>
</tbody>
</table>
Trust Owned LTCi

Concept

- Wealth shifting strategy
- Best suited for high-net worth client who cannot establish a need financially for additional life insurance coverage
  - Client contemplates using personal wealth to cover LTC expenses

Note: Third party ownership may not be available in all states and for certain products.
Trust Owned LTCi

Three strategies:
- Benefits left to accumulate in trust
- Trustee pays benefits to beneficiaries / beneficiaries pay LTC expenses
  - IRC § 2503(e) medical care gift tax exclusion
- Domestic self-settled spendthrift trust

Premium gifts
- IRC § 2503(b)

For Producer And Professional Advisor Use Only.
Not For Use With The Public.
Trust Owned LTCi

Considerations

- Trust must be irrevocable and authorized to purchase LTCi
- Transfers to trust must qualify as gifts of present interest – Crummey provisions required
- Grantor cannot retain either directly or indirectly a right to LTC benefits
  - Benefits left to accumulate in trust
  - Trustee pays benefits to beneficiaries / beneficiaries pay LTC expenses
    - IRC § 2503(e) medical care gift tax exclusion
    - Domestic self-settled spendthrift trust
Domestic self-settled spendthrift trust

- AK, CO, DE, MS, NH, NV, OK, RI, SD, TN, UT & WY
- Requirements
  - Trustee given *discretion* to make distributions
  - Trust is irrevocable
  - Trust document expressly states that the laws of the state where it is located govern the trust
  - Document must include a spendthrift provision
  - Trustee must be a resident of the state
Domestic Asset Protection Trust
Estate Tax Considerations

- IRC § 2038(a)(1) – power to alter, amend, revoke or terminate trust
  - Not includible because creditors cannot reach trust assets?

- IRC § 2036(a)(1) – “possession or enjoyment of, or the right to the income from, the property”
  - Not includible because of trustee’s absolute discretion?

- IRC § 2036(a)(2) – “designate the persons who shall possess or enjoy the property or the income therefrom”
  - Not includible because designed as completed gift?
“Any plan of an employer providing coverage under a qualified long-term care insurance contract shall be treated as an accident and health plan with respect to such coverage.”

IRC § 7702B(a)(3)
Employer Provided LTCi

IRC § § 105, 106 & 162(a)

Employer

Select Employee
Spouse
Dependents
Children under age 27

Insurance Company

Employer paid premiums deductible expense
• IRC § 162(a)

Employer provided coverage not included in employee’s gross income
• IRC § 106(a)

Benefits income tax free
• IRC § 105(b)

For Producer And Professional Advisor Use Only.
Not For Use With The Public.
Where the employer is not directly or indirectly a beneficiary under the policy, premium payments may be deducted as an ordinary and necessary business expense if it can be shown …

- That premiums are paid in consideration of personal services actually rendered to the employer, and
- That the total amount paid the employee, including the premiums, was not unreasonable compensation for his or her services

IRC § 162(a); Rev. Rul. 58-90
1. The employee's qualifications
2. The nature, extent and scope of the employee's work
3. The size and complexities of the business
4. A comparison of salaries paid with gross income and net income
5. The prevailing general economic conditions
6. Comparison of salaries with distributions to stockholders
7. The prevailing rates of compensation for comparable positions in comparable enterprises
8. The salary policy of the taxpayer as to all employees
9. Compensation paid in prior years
Compensation paid is presumptively reasonable if a hypothetical independent investor would consider the rate of return on his investment in the taxpayer’s corporation “a far higher return than … [he] had any reason to expect”

Presumption rebutted if …
- An extraordinary event was responsible for the company's profitability, or
- The executive's position was merely titular and his job was actually performed by someone else
“Except as otherwise provided …, gross income of an employee does not include employer-provided coverage under an accident or health plan.”

IRC § 106(a)

“… gross income does not include amounts … paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213(d)) of the taxpayer, his spouse, his dependents and any child …. who as of the end of the taxable year has not attained age 27.”

IRC § 105(b)
“A plan may cover one or more employees, and there may be different plans for different employees or classes of employees. An accident and health plan may be either insured or noninsured, and it is not necessary that the plan be in writing or that the employee’s rights to benefits under the plan be enforceable.”

Reg. § 1.105-5
“The gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in section 152.”

Reg. § 1.106-1

Beginning March 30, 2010, coverage provided by an employer for a child of the employee who has not attained age 27 as of the end of the tax year is also excluded from income.

Notice 2010-38
“... amounts paid by the company under the plan as its share of the cost of providing ... coverage (under a health and accident plan) for the retired employee are excludable from his gross income for purposes of section 106 ....”

Rev. Rul. 62-199
Employer Provided LTCi

IRC §§ 105, 106 & 162(a)

- Employer-employee relationship
  - Rev. Rul. 87-41
- Premiums deductible by employer (if reasonable)
  - IRC § 162(a)
- Premiums excluded from employee’s gross income
  - IRC § 106(a)
- Income tax free benefits
  - IRC § 105(b)
- No nondiscrimination requirements
  - Reg. § 1.105-5
- Plan can cover employee, spouse, dependents & children under age 27
  - Reg. § 1.106-1; Notice 2010-38
- Plan can cover retirees
  - Rev. Rul. 62-199
Split-premium LTCi

- Percentage split
- Benefit split
- Elimination period split
- Benefit period split
- Rider split
Refund of Premium

“Any refund on a complete surrender or cancellation of the contract shall be includible in gross income to the extent that any deduction or exclusion was allowable with respect to the premiums.”

IRC § 7702B(b)(2)(C)
Employer provides base LTCi coverage

Employee pays for full nonforfeiture

Employee’s portion income taxable

Insurance Company

Refund of premium

Beneficiary

Employee’s portion income tax free
“… gross income of an employee shall include employer-provided coverage for qualified long-term care services … to the extent that such coverage is provided through a flexible spending or similar arrangement.”

IRC § 106(c)(1)

The term ‘qualified benefit’ “…shall not include any product which is advertised, marketed, or offered as long-term care insurance.”

IRC § 125(f)
“… a health FSA is not permitted to reimburse expenses for long-term care insurance premiums or for long-term care services for the employee or employee’s spouse or dependent.”

Prop. Reg. § 1.125-5(k)(4)

[“Taxpayers may rely,” Prop Reg. 8/6/2007]
Self-Employed Health Insurance Deduction
IRC § 162(l)

**Sole Proprietorship**
- Partnership
- LLC
- S Corp

Gross income earned by the business entity
- Employee benefits deductible under IRC § 162(a)
- Owners are not employees

**Net income distributed to owners**
- Included in owners’ income under IRC §§ 61, 707, 1372

**Sole Proprietor**
- Partner
- Member
- 2% Shareholder

**Insurance Company**

LTCi premium paid from distributive share
- IRC § 162(l) deduction

For Producer And Professional Advisor Use Only.
Not For Use With The Public.
“In the case of an individual [who is self-employed] … there shall be allowed as a deduction … the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.”

IRC § 162(l)(1)

As of March 30, 2010, the deduction under § 162(1) also extends to coverage for the self-employed individual’s children who have not attained age 27 as of the end of the tax year.

Notice 2010-38

“In the case of a qualified long-term care insurance contract …, only eligible long-term care premiums … shall be taken into account ….”

IRC § 162(l)(2)(C)
Self-employed individuals include sole proprietors, partners in partnership, members in LLC, 2% shareholders in S corporation.
Deduction available to taxpayer, spouse, dependents & children under age 27.
Limited to eligible LTC premium, not to exceed self-employment income.
Taken on Line 29 of IRS Form 1040 (2012).
Not subject to 10% AGI threshold.
Deduction not allowed for self-employment tax purposes. IRC § 162(1)(4).
- Partnership/LLC provided LTCi. Rev. Rul. 91-26
  - Premium deductible by partnership/LLC. IRC § 162(a)
    - Partner/member, spouse, dependents & children under age 27
  - Guaranteed payment to partner/member. IRC § 707(c)
    - Reported on IRS Form 1065 & Schedule K-1
  - Premium included in partner’s/member’s income. IRC § 61
  - Partner/member can deduct eligible LTC premium. IRC §§ 162(l), 213(d)(1)(D), 213(d)(10)
Jones & Davis, LLC
Jones (age 55), LTCi joint premium = $4,000

IRS Form 1040
Distributive share (Schedule K-1) $130,000
LTCi premium (guaranteed payment) 4,000
Business income $134,000
   Eligible LTC premium for him 1,360
   Eligible LTC premium for wife 1,360
Self-employed health insurance deduction (2,720)
Adjusted Gross Income $131,280
S corporation provided LTCi. Rev. Rul. 91-26

- Premium deductible to S corporation. IRC § 162(a)
  - 2-percent shareholder, spouse, dependents & children under age 27
- Treated like guaranteed payments under IRC § 707(c).
  - Reported on IRS Form 1120S & Form W-2
- Premium included in 2-percent shareholder’s income.
  IRC § 61
- 2-percent shareholder can deduct eligible LTC premium. IRC §§ 162(l), 213(d)(1)(D), 213(d)(10)
S corporation provided LTCi. Notice 2008-1

- Plan “established by the S corporation” if two requirements are met:
  - S corporation pays the premium, or
  - S corporation reimburses shareholder-employee upon proof of premium payment

- Two additional requirements
  - S corporation must report premiums paid or reimbursed as wages on Form W-2
  - 2-percent shareholder must report premium payments or reimbursements as gross income
J. Barnes, CPA (S Corp)
Jim (age 54), LTCi premium = $2,000

IRS Form 1040
Distributive share (Schedule K-1) $30,000
Salary w/ LTCi (W-2) 32,000
Business income $62,000
  Eligible LTC premium 1,360
Self-employed health insurance deduction (1,360)
Adjusted Gross Income $60,640
Moving the Deduction

From:
Self-employed Health Insurance Deduction
• IRS Form 1040, Line 29
• IRC § 162(l)
• “Eligible” premium

To:
Employee Benefit Programs
• IRS Form 1040, Schedule C
• IRS Form 1065
• IRS Form 1120S
• IRC § 162(a)
• Actual premium

By:
Spouse as bona fide employee
• Rev. Rul. 71-588
Employer-Employee Relationship
Rev. Rul. 87-41

- Instructions
- Training
- Integration
- Services Rendered Personally
- Hiring, Supervising, and Paying Assistants
- Continuing Relationship
- Set Hours of Work
- Full Time Required
- Doing Work on Employer's Premises
- Order or Sequence Set

- Oral or Written Reports
- Payment by Hour, Week, Month
- Payment of Business and/or Traveling Expenses
- Furnishing of Tools and Materials
- Significant Investment
- Realization of Profit or Loss
- Working for More Than One Firm at a Time
- Making Service Available to General Public
- Right to Discharge
- Right to Terminate
“… the term ‘2-percent shareholder’ means any person who owns (or is considered as owning within the meaning of section 318) … more than 2 percent of the outstanding stock …."

IRC § 1372(b)
Medical Expense Deduction
- IRS Form 1040, Schedule A
- IRC §§ 213(a), 213(d)(1)(D)
- “Eligible” premium

Self-employed Health Insurance Deduction
- IRS Form 1040, Line 29
- IRC § 162(l)
- “Eligible” premium

Employee Benefit Programs
- IRS Form 1120
- IRS Form 1120S
- IRS Form 1040, Schedule C
- IRS Form 1065
- IRS Form 990
- IRC §§ 105, 106, 162(a)
- Actual premium
- General tax treatment: Same as other life insurance
  - tax free death benefits
  - tax deferred growth within the life insurance policy
  - basis out first when taking policy distributions
  - policy loans are not treated as distributions, etc.

  **Exception: MEC contracts**
How are benefits paid when policy is owned by Insured or Insured’s spouse?

- Income tax free advance of the policy’s death benefit
- Payment from MassMutual must be to the individual who actually paid or is deemed to have paid the costs for long term care services provided to the Insured
- When an LTCAccessSM Rider benefit payment is made, a reduction is made in the cost basis of the life insurance policy in the same proportion as the LTCAccess benefit payment is to the total policy death benefit.
How are the distributions taxed if the policy is owned by a 3rd party?

- If owner not legally obligated to pay for the insured’s LTC expenses, the rider benefits will be treated as withdrawals from the life insurance policy instead of an income tax free advance of the policy’s death benefit.

- Distributions from the life policy will be treated as income tax free distributions until the owner has fully recovered his or her cost basis, then further distributions will be taxed as ordinary income.

- Payments are still treated by MassMutual as an acceleration of the policy death benefit. So, the payment will also result in a proportionate reduction in the policy’s net cash value.
What about using the LTCAccessSM Rider on a MEC policy?

- Benefit payments will still be treated for federal income tax purposes as an acceleration of the life policy death benefit, if the owner of the policy is the insured or the insured’s spouse;

- If it is owned by a 3rd party, it is treated as a policy distribution and treated as taxable first like all MEC policies;

- An additional 10% penalty tax applies to income distributed from a MEC prior to the policyowner’s attainment of age 59 ½.
What Did We Cover

- Must Know Basics of life insurance taxation
  - Withdrawals taxed after basis
- Taxation of MEC policies
  - Withdrawals taxed from first dollar
- Taxation of life insurance for business uses
  - Transfer for value
- Taxation of life insurance policies with LTCAccess\textsuperscript{SM} Rider
  - 3\textsuperscript{rd} party ownership is possible, but important to be careful
Thank You!

Long term care insurance policy issued by MassMutual, Springfield MA 01111-0001.