TRANSAMERICA LIFE INSURANCE COMPANY

TRANSAMERICA FINANCIAL LIFE INSURANCE COMPANY

Frequently Asked Tax Questions for Long Term Care Insurance

Facts for Agents and Producers
2017 Edition

For Agent/Producer use only.
Not for solicitation or reproduction.

TRANSAMERICA®

TLC A TG 1216

TABLE OF CONTENTS

There are a variety of tax issues that could affect your clients when purchasing Long Term Care insurance. This collection of Frequently Asked Questions (FAQs) is intended to help give you a better understanding of tax laws applicable to Long Term Care insurance. It is based upon current interpretations of tax laws in effect. Changes in the law may affect the information, including any examples given. These FAQs should not take the place of professional tax advice. Transamerica Life Insurance Company, Transamerica Financial Life Insurance Company, and its agents and representatives do not give tax or legal advice. This material and the concepts presented here are for information purposes only and should not be construed as tax or legal advice. Any tax and/or legal advice you may require or rely on regarding this material should be based on your particular circumstances and should be obtained from an independent professional advisor.

Nothing in these FAQs can substitute for professional tax advice for your customers. You should encourage customers to seek tax advice, and to refrain from making purchase decisions until they receive it. These FAQs should not be handed to or left with any customer.

*In NY, Transamerica Financial Life Insurance Company.

INDIVIDUAL TAXPAYERS

Q For an individual taxpayer, what is the general rule regarding the deductibility of premium payments for a tax-qualified Long Term Care insurance (TQ LTCI) policy?

Premiums paid for a tax-qualified Long Term Care insurance policy (a TQ "LTCI" policy) are deductible personal medical expenses for those taxpayers who itemize their taxes (Internal Revenue Code ("IRC") Sec. 213). Naturally, TQ LTCI premium deductions are subject to the same tax rules as traditional medical expenses, such as being subject to the 10% threshold based on the individual's adjusted gross income ("AGI").

In arriving at the amount of TQ LTCI expenses in excess of the 10% threshold normally available, premiums paid for TQ LTCI are subject to the following dollar limits based on the individual taxpayer's attained age before the close of the tax year ("eligible premiums" or "eligible TQ LTCI"):

Q What is the taxability of benefits received by an individual taxpayer under a personal TQ LTCI contract?

Generally, when an individual taxpayer receives benefits under a TQ LTCI policy (other than policy owner dividends or premium refunds), except when the benefits reimburse for expenses allowable as deductions in prior years, the benefits are excludable from income as amounts received for personal injuries and sickness. Payments made under a TQ LTCI policy that are made without regard to the actual LTCI expenses that a taxpayer incurs for long term care services are only excludable from a taxpayer's income to a certain extent. The exclusion from income of such payments is limited to the greater of (a) $410[1] a day (the "per diem" limit) ($149,650 annually) (for 2017-adjusted annually for inflation) or (b) the costs the taxpayer actually incurred for long term care services reduced by reimbursements for qualified long term care expenses from other sources.

Q Can an individual taxpayer use tax-sheilded funds, such as a Health Savings Fund (HSA) to pay TQ LTCI policy premiums?

Employer contributions to Health Savings Accounts (HSAs) are not subject to Federal Income Tax or FICA. Employee contributions to an HSA are deductible but do not reduce FICA. Qualified Transamerica Long Term Care insurance premiums may be paid through the HSA up to a maximum established by the Federal Government each year (See Eligible Tax Deduction Limits).[3]

Eligible Tax Deduction Limits[1]

Age	2015 Individual Eligible Premium Limits	2016 Individual Eligible Premium Limits	2017 Individual Eligible Premium Limits	2017 Eligible Premium Limits for Couples[2]
Less than 40	$ 380	$ 390	$ 410	$ 820
41-50	$ 710	$ 730	$ 770	$ 1,540
51-60	$ 1,430	$ 1,460	$ 1,530	$ 3,060
61-70	$ 3,800	$ 3,900	$ 4,090	$ 8,180
Over 70	$ 4,750	$ 4,870	$ 5,110	$ 10,220

[1]IRS Revenue Procedure, 2016-55
[2]For couples of the same age in 2017.
[3]See Internal Revenue Service Publication 502 and Publication 15 for details and limitations.

SELF-EMPLOYED INDIVIDUALS & SOLE PROPRIETORS

Q For a self-employed individual taxpayer or sole proprietor, what is the general rule regarding deductibility of premium payments for a TQ LTCI policy?

For the purposes of the self-employed health insurance deduction, eligible TQ LTCI premiums are treated as medical insurance premiums subject to the same limits as for individual taxpayers. As such, eligible TQ LTCI premiums paid by the self-employed individual for himself, spouse and dependents during the tax year are deductible as self-employed health insurance, and the balance is deductible as a medical expense up to the amount of Earned Income from the trade or business for the year. Eligible TQ LTCI premiums in excess of Earned Income are deductible, subject to the cap on eligible premiums and to the 10% of AGI threshold. IRC Sections 162(l) and 213(d).

The following limits still apply:

Eligible Tax Deduction Limits for 2017[1]		
Age	**Eligible Premium Limits for Individuals**	**Eligible Premium Limits for Couples[2]**
Less than 40	$ 410	$ 820
41-50	$ 770	$ 1,540
51-60	$ 1,530	$ 3,060
61-70	$ 4,090	$ 8,180
Over 70	$ 5,110	$ 10,220

An Example...

Paul, currently a 51 year-old, self-employed electrician purchased TQ LTCI policies for him and his wife, who is the same age, with a combined annual premium of $4,100. In 2017, 100% of the Eligible Premium, up to the 2017 Tax Deduction Limits, may be deducted as self-employed health insurance. According to the Tax Deduction Limits for 2017 table, Paul is allowed to include $3,060 of his TQ LTCI premium as a medical expense when calculating his medical expense deduction. (The calculations below illustrate the medical expense deduction if Paul and his wife were 51 and 61 in tax year 2017.)

For the 2017 Tax Year:		
	Age 51	Age 61
Eligible TQ LTCI Premium:	$ 3,060	$ 4,100
Percentage of Eligible Premium:	75%	100%
Self-Employed Health Insurance Deduction:	$ 3,060	$ 4,100

Q How are the self-employed individual taxpayer's benefits under the TQ LTCI treated for tax purposes?

The benefits received by a self-employed individual are generally excludable from gross income, subject to the same limitations as for individual taxpayers.

[3]IRS Revenue Procedure, 2016-55.
[4]For couples of the same age in 2017.

PARTNERSHIPS

(PARTNERSHIPS, LIMITED PARTNERSHIPS & FAMILY LIMITED PARTNERSHIPS)

Q *What is the general rule regarding deductibility of premium payments for TQ LTCI policies purchased by a partnership…*

…for a non-partner employee?
If a Partnership purchases a TQ LTCI policy for a non-partner employee (and/or a non-partner employee's spouse), the Partnership may deduct the entire premium as a reasonable and necessary business expense (IRC Sec. 162) if the Partnership does not retain any beneficiary interest in the policy.

…for a partner?
If the Partnership purchases a TQ LTCI policy for a partner (or the spouse and dependents of a partner), the entire amount of the TQ LTCI premiums paid by the Partnership is includable in the partner's gross income. In turn, the partner is treated as a self-employed individual and eligible TQ LTCI premiums are subject to the same tax rules as discussed for self-employed individuals.

Any balance of eligible TQ LTCI premiums above the amount deductible as self-employed health insurance by the partner may be added to other unreimbursed medical expenses in applying the 10% of AGI threshold test for medical deductions.

An Example...
Brothers and Associates, a Partnership for Federal Income Tax purposes, purchased a TQ LTCI policy for James Brothers, a partner who was 61 years old in 2017. The annual premium of $3,100 is paid by the Partnership.

Since the deductible eligible premium limit for James is $3,900, he can deduct on his personal return the full $4,090 paid as premium.

Q *For a Partnership-paid TQ LTCI policy, what is the taxability of benefits received by either a non-partner employee or a partner?*

When an employee of a Partnership receives benefits under a Partnership-paid TQ LTCI policy, the benefits are generally excludable from income just as they would be for any employer-paid health insurance benefit. The benefits received by a partner are generally excludable from gross income, subject to the same limitations as for individual taxpayers.

NOTE: These same tax-free benefit rules would apply to Limited Partnerships.

Q *What are the rules concerning a Family Limited Partnership ("FLP")?*

Assuming the FLP is a valid partnership for federal income tax purposes, the same Partnership tax rules on deductibility of premiums and taxation of benefits that have been discussed are applied. Thus, TQ LTCI premiums paid by the FLP on behalf of a partner or employee are fully deductible by the FLP but represent income to the partner. The partner is treated as a self-employed individual for purposes of deducting eligible TQ LTCI premiums. With respect to TQ LTCI premiums paid by the FLP for employees who are not partners (including partners' spouses who are also employees), the same rules apply as in any other employer-employee situation.

C-CORPORATIONS

Q *What is the general rule regarding TQ LTCI premium payments made by a C-Corporation Employer…*

…on behalf of an employee?

Where a C-corporation purchases a TQ LTCI policy for an employee, the C-Corporation may deduct the entire premium as a reasonable and necessary business expense (IRC Sec. 162) if the C-Corporation does not retain any beneficiary interest in the policy.

…on behalf of a stockholder who is not an employee?

Where a C-Corporation purchases a TQ LTCI policy for a non-employee shareholder, there is no deduction for the C-Corporation under IRC Sec. 162 and premiums represent dividend income to the shareholder.

Q *How do TQ LTCI premium payments made by a C-Corporation for an employee affect the employee's gross income for tax purposes?*

Employer-paid TQ LTCI policy premiums are excludable from an employee's gross income (IRC Sec. 106). This exclusion can apply to coverage provided to an employee's spouse and tax dependents, before and after death, as well as to retired former employees.

Q *What is the taxability of benefits received by an employee under a TQ LTCI policy purchased for the employee by a C-Corporation?*

Benefits received are generally excludable from an employee's gross income. However, where the policy reimburses LTC expenses, benefits must be included in gross income to the extent they reimburse the employee for medical expenses deducted in prior years or exceed current actual TQ LTCI expenses.

If the TQ LTCI policy simply pays a daily benefit without regard to long-term care expenses incurred, the benefit is taxable to the extent it exceeds the "per diem" limit. (See page 3).

Q *In a contributory arrangement, where an employee is contributing to the payment of the TQ LTCI premiums, what are the tax implications with respect to the premiums paid…*

…for the employee?

Employer-paid TQ LTCI premiums are excludable from an employee's income (IRC Sec. 106). Thus, the employee may exclude the entire employer-paid premium from his or her gross income.

Premium payments made by the employee to augment those contributed by the employer will be treated as though they are paid by an Individual Taxpayer, subject to the tax rules described on page 3.

…for the employer?

If the employer contributes a portion of the premiums for a TQ LTCI policy for an employee (and/or employee's spouse), the employer may deduct the entire amount it contributes as a reasonable and necessary business expense (IRC Sec. 162) if the employer retains no beneficiary interest in the policy.

Q *What is the taxability of benefits received by an employee under a TQ LTCI policy purchased in a contributory arrangement (where the employee is contributing to the payment of the TQ LTCI premiums)?*

Benefits received are generally excludable from an employee's gross income. However, benefits must be included in gross income to the extent they reimburse the employee for any medical expenses deducted in prior years by the employee.

C-CORPORATIONS

Q *For the purposes of employer-paid TQ LTCI premiums, are Not-for-Profit Organizations under IRC Sec. 501(c) treated any differently than a C-Corporation?*

Not-for-profit organizations may establish an employer-paid health plan that is available to for-profit organizations. Thus the same principles would apply.

Q *A C-Corporation wishes to purchase a TQ LTCI policy for its key employee or Shareholder (sole or not).*

The C-Corporation would pay the entire premium. The Shareholder would be the owner of the policy. There would be no other TQ LTCI policies purchased by the C-Corporation.

1. Is the TQ LTCI premium paid by the C-Corporation deductible?

The entire amount of the premium may be deductible under IRC Section 162, provided that:

a) the C-Corporation has not retained any beneficiary interest in the TQ LTCI policy - this is also a plus for purposes of avoiding any accumulated earnings tax that may otherwise be imposed;

b) the Shareholder is a bona fide employee of the C-Corporation; and

c) the amount of the premium (when added to other amounts paid to the shareholder) does not exceed reasonable compensation to the shareholder as an employee of the corporation.

If the Shareholder is not a bona fide employee of the C-Corporation, no deduction is available since this would represent dividend income to the Shareholder.

If the C-Corporation retains any interest in the TQ LTCI policy, this might make the premium non-deductible in whole or in part.

2. What are the tax consequences to the Shareholder?

a) If the Shareholder is a bona fide employee of the C-Corporation, the premium is generally excludable from income under IRC Sec. 106. Similarly, subsequent benefit payments under the TQ LTCI are generally excludable from income to the extent they reimburse medical expenses deducted by the employee in prior years.

b) If the Shareholder is not a bona fide employee of the C-Corporation, the premium represents dividend income. The Shareholder would then be treated as an individual taxpayer for purposes of any available deduction under IRC Sec. 213 (subject to the annual cap for TQ LTCI premium and the 10% of AGI threshold).

In the future, as benefit payments are received, except to the extent the benefits reimburse for medical expenses deducted by the employee in prior years, nothing should be includable in income since the Shareholder is treated as having personally purchased the TQ LTCI policy.

C-CORPORATIONS

Q *A C-Corporation wishes to purchase TQ LTCI for a member of its Board of Directors. What are the tax ramifications for the C-Corporation and the Director?*

If the Director is not also an employee, the TQ LTCI policy is not covered by the tax-favored health benefit plan rules for employees under IRC Secs. 105-106.

As a non-employee, the Director will have taxable compensation on any TQ LTCI premium paid on his behalf. The TQ LTCI policy is, in effect, a personal policy purchased with after-tax dollars and is treated in the same way as any other personal policy. The benefit payable under the TQ LTCI will be generally tax-free as with any other personal policy. See page 3.

The answer should be the same for the Director when the employer is a not-for-profit organization.

If the Director is also an employee, the Director will be subject to the same tax treatment as an employee if the Director receives the benefit in his or her capacity as an employee. This will be a question of fact. The Director and his or her tax advisors should review the necessary requirements.

If the Director is a shareholder as well as an employee, the IRS may argue that the payment of the premium is a dividend to a shareholder rather than compensation to a Director or an employee. If the payments were considered to be a dividend, it would not be deductible by the employer. Again, whether the premium relates to shareholder status will be a factual issue. In each situation, the Director and his or her tax advisors should assess this issue.

Q *Generally speaking, a C-Corporation may purchase TQ LTCI for a Key Executive and deduct premiums as a business expense. The C-Corporation may also purchase TQ LTCI for that Key Executive's spouse/parents and deduct that as a business expense as long as it can be considered reasonable compensation for the Key Executive. May a C-Corporation purchase coverage for the Key Executive's (A) parent or stepparent, (B) legal guardian, or (C) unofficial childhood guardian – whether related or not and deduct the premium as a business expense?*

The people mentioned, whether related to the Key Executive or not, would not typically be tax dependents of the employee. Nevertheless, the employer should be able to deduct the premium as a business expense if the premium is treated as additional compensation to the Key Executive. This also assumes that the compensation is reasonable and qualifies under the general rules for deduction of salary expense. Benefits received by such persons should be treated as from a personal individual policy.

The taxation of the employee, though, is affected by whether the listed individuals are a spouse or "tax dependents" as defined under IRC Sec. 152. That will be a factual question dependent on the circumstances of each case. If the person is a spouse or a tax dependent, the premium paid by the employer would not be taxable to the employee under IRC Sec. 106 (a), and the benefits would be excluded from income as under other employee policies.

S-CORPORATIONS

Q *What is the general rule regarding deductibility of premium payments made by an S-Corporation on behalf…*

…of an employee or a shareholder owning less than or equal to 2% of the stock ("<2% shareholder")?
An S-Corp may deduct premiums paid for a TQ LTCI policy for an employee or a <2% shareholder as a reasonable and necessary business expense (IRC Sec. 162) if the S-Corp retains no beneficiary interest in the policy.

…of a shareholder who owns more than 2% of the stock ("2% shareholder"[5])?
With respect to fringe benefits, a 2% shareholder[5] is treated in the same way as a partner for federal tax purposes. Any TQ LTCI premiums paid by an S-Corp on behalf of a 2% shareholder are similarly deductible by the S-Corp under IRC Sec. 162 if the S-Corp retains no beneficiary interest in the policy.

Q *What is the effect of an S-Corporation purchasing a TQ LTCI policy…*

…for an employee or a <2% shareholder?
The employee or <2% shareholder may exclude from income the premiums paid by the S-Corp under IRC Sec. 106.

…for a 2% shareholder?
2% shareholders[5] are required to include the entire amount of the TQ LTCI premiums paid by the S-Corp in their gross income. However, the 2% shareholder would be treated as a self-employed individual for purposes of any available tax deduction. Thus, as is the case for partners in Partnerships, eligible TQ LTCI premiums are deductible by the 2% shareholder as self-employed health insurance, and any eligible premium paid in excess of earned income may be added to other unreimbursed medical expenses in applying the 10% of AGI test for self-employed individuals.

The same rules apply to any TQ LTCI premiums paid by the S-Corp for the 2% shareholder's spouse (even if the spouse is also an employee) and/or tax dependent.

Q *A brother and sister own all interests in an S-Corporation where the brother's and sister's parents are employed. What would be the taxable consequences if the S-Corporation were to purchase TQ LTCI for the employee parents?*

Though the parents are employees of the S-Corp and own no actual stock in the S-Corp, the parents are considered 2% shareholders[5] by virtue of the attribution rules of IRC Sec. 318. IRC Sec. 318 (a) (1) provides that an individual is considered to own the stock owned directly or indirectly by his or her children. Thus, in this scenario the parents are 2% shareholders.

As such, any TQ LTCI premium paid by the S-Corp on behalf of the employee parents would be included in the parents' gross income.

Q *Generally, what is the rule regarding deductibility of TQ LTCI premiums paid by a Limited Liability Company ("LLC") that is taxed as a partnership?*

…of a non-owner employee:
If the LLC purchases a TQ LTCI policy for a non-owner employee (and/or a non-owner employee's spouse), the company may deduct the full amount of the premium as a reasonable and ordinary business expense (IRC Sec. 162) if the LLC retains no beneficiary interest in the policy.

…as an owner or part-owner?
If the LLC purchases a TQ LTCI policy for an owner or part-owner in the LLC, the owner will be considered a partner for tax purposes.

[5]A "2% shareholder" is defined by the statute as owning more than 2%. An owner of "2% or less" is not considered a 2% shareholder.

GENERAL TOPICS

Q *May an employer pay for TQ LTCI premiums for select employees without providing the same coverage for other employees?*

An employer may select which employees receive TQ LTCI, provided that the HIPAA non-discrimination rules (relating to eligibility discrimination based on health factors) are met.

Q *What other special rules pertain to employer-paid TQ LTCI plans?*

First, no product which is advertised, marketed or offered as TQ LTCI is a "qualified benefit" for purposes of cafeteria plan rules under (IRC Sec. 125(f)).

Second, employer-paid TQ LTCI policies are NOT covered under ERISA (the Employee Retirement Income Security Act of 1974).

Third, employer-paid TQ LTCI provided through a Flexible Spending Account is included in the employee's gross income (IRC Sec. 106(c)(1)).

Fourth, COBRA continuation coverage requirements that apply to group health plans do not apply to plans under which substantially all of the coverage is TQ LTCI (IRC Sec. 4980B(g)(2)).

Employers will need to rely on their legal counsel for guidance on these issues.

Q *If a corporation purchases and retains ownership in a TQ LTCI policy which includes a Return of Premium Upon Death Rider in the policy, can the corporation deduct the full amount of the paid premium and then receive the ROP proceeds tax-free?*

IRC Sec. 7702B (b)(2)(C) allows a TQ LTCI policy to provide a refund (that does not exceed the aggregate premiums paid under the policy) upon either:

1. the death of the insured; or
2. complete surrender or cancellation of the policy.

However, only in the latter case (i.e., a refund upon complete surrender or cancellation) IRC Sec. 7702B (b)(2)(C) requires that the refund be included in gross income, to the extent that any deduction or exclusion was allowable with respect to the premiums.

In addition, where the premium refund is payable upon death of the insured to the employer, such a retained interest in the policy by the employer should not jeopardize its deduction for the premium, but the refund should be includable in the employer's gross income to the same extent as a refund upon cancellation. (IRC Sec. 7702B (a))

Q *If an employer pays the premium for TQ LTCI coverage for both an employee and the employee's spouse, can the employer deduct both of these premium payments as business expenses?*

Generally, yes, provided the employer does not retain any beneficiary interest in the policy. Employer-paid coverage for an employee or spouse of an employee may be deductible as a reasonable and necessary business expense. For such coverage purchased by a "self-employed" individual (i.e., sole proprietor or partner in partnership), only a portion of these expenses may be deducted.

GENERAL TOPICS

Q *What are the ramifications if a policyholder wishes to upgrade an existing, grandfathered plan?*

Generally, any policy that was issued prior to January 1, 1997, which met the TQ LTCI requirements of the state in which the policy was issued, is treated as a TQ LTCI contract. Benefits provided under such policies will similarly be treated as TQ LTCI.

According to the regulations issued pursuant to IRC Sec. 7702B, a policy issued after December 31, 1996 in exchange for a pre-1997 policy, is considered a new policy and if certain changes are made to a pre-1997 policy, that policy is treated as the issuance of a new policy.

For this purpose, a change that eliminates grandfathered tax status generally includes:

1. a change in the terms of the policy that alters the amount/timing of an item payable to the policyholder, the insured or the insurance company;
2. a substitution of the insured under an individual policy; or
3. a change in the eligibility for membership in the group covered under a group policy. The IRC Sec. 7702B regulations provide a list of exceptions.

Consequently, care should taken in deciding how pre-1997 policies should be "upgraded" in these situations.

Employers will need to rely on their legal counsel for guidance on these issues.

Q *Will premiums paid by an employer for an employee's parents' coverage be added to the employee's gross income?*

Generally, employer-paid health coverage is excludable from an employee's gross income as long as the coverage is provided for "tax dependents" of the employee. "Tax dependents" are defined by reference to IRC Sec. 152 for standard exemption and other income tax return purposes. Thus, so long as the parent for whom the coverage was provided is a tax dependent of the employee, the employer-paid coverage should not be included in the employee's gross income. If however, the parent is not a tax dependent of the employee, the employer-paid coverage will be considered taxable income to the employee.

TRANSAMERICA LIFE INSURANCE COMPANY

TRANSAMERICA FINANCIAL LIFE INSURANCE COMPANY

This is an individual Long Term Care insurance policy underwritten by Transamerica Life Insurance Company, Cedar Rapids, IA, in NY, Transamerica Financial Life Insurance Company, Harrison, NY.

Transamerica Life Insurance Company
Home Office: Cedar Rapids, Iowa

Transamerica Financial Life Insurance Company
Home Office: Harrison, NY

Administrative Office: P.O. Box 869093 • Plano, TX 75086-9093

TRANSAMERICA®