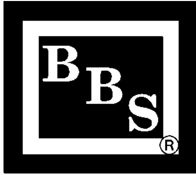

TAXLOGIC

February 8, 2002 **Vol. 1, No. 15**

We provide a prompt, professional, personal one-on-one tax preparation service from the comfort of your home or office. We are competitively priced; in addition we offer a number of additional services as well as comprehensive information from our web site – http://www.taxlogic.com.

Long-Term Care Health Insurance Contracts

We touched on this topic in last week's newsletter, but today, we will go into more details. Long-term insurance contracts issued after 1996 generally are treated for income tax purposes in the same way as accident and health insurance contracts. Employer-proved long-term care insurance will be received tax-free. The premiums that are eligible for a medical deduction are those paid during the year for a qualified contract. The amount of the premium that is deductible is limited by the age of the individual at the close of the tax year. For those limits please visit our web site at http://www.taxlogic.com.

Long-term care coverage cannot be provided through a flexible spending arrangement, (commonly called a Sec 125 Plan) and employer-provided long-term care coverage under a cafeteria plan is included in the employee's income. Any income you receive from them (other than policyholder dividends or premium refunds) generally are excludable from income, as amounts received for personal injury or sickness.

A qualified long-term insurance contract is an insurance contract that provides only coverage of qualified long-term care services. The contract must be as follows:

1. Be guaranteed renewable.
2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged or borrowed.
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits, and
4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer or the contract makes per diem or other periodic payments without regard to expenses.

Unreimbursed long-term care expenses are treated as medical expenses, as long as a relative does not provide the care, unless the relative is licensed to provide these services.

Long-term care expenses are those for necessary diagnostic, preventive, therapeutic, curing, treating, mitigation and rehabilitative services, and maintenance or personal care services required by a chronically ill individual. A chronically ill individual is one who has been certified within the previous 12 months by a licensed health care practitioner as:

1. Being unable to perform, without substantial assistance, at least two activities of daily living for at least 90 days due to loss of functional capacity.
2. Having a similar level of disability as determined by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services, or
3. Requiring substantial supervision to protect him from threats to health and safety due to severe cognitive impairment. Activities of daily living for this purpose are eating, toileting, transferring, bathing, dressing and continence.

The new law provides several tax breaks to help make qualified long-term care insurance more affordable. No gain or loss is recognized on a pre-existing long-term care contract that is exchanged for a qualified long-term care insurance contract after the date of enactment and before January 1, 1998. The same is true if a pre-existing long-term care contract is canceled and its proceeds are reinvested in a qualified long-term care contract within 60 days. However, gain must be recognized to the extent of any other money or property received in exchange for the old policy.

Although employer-provided long-term care coverage generally is treated as a health plan, employers that offer such coverage are not required to provide COBRA continuation coverage for long-term care coverage to employees or dependents that lose their health insurance coverage.

The exclusion for payments made on a per diem or other periodic basis under the insurance contract is subject to a limit. The limit applies to the total of these payments and any accelerated death benefits made on a per diem or other periodic basis under a life insurance contract because the insured is chronically ill. Under this limit, the excludable amount for any period is calculated by subtracting any reimbursement received (through insurance or otherwise) for the cost of qualified long-term care services during the period from the larger of the following amounts.

1. The cost of qualified long-term care services during the period.
2. The dollar amount for the period ($200 per day for any period in 2001).

See section C of Form 8853 and its instructions for more information.

To get more information on the issue of the long-term health insurance treatment deduction, please visit our site at http://www.taxlogic.com.