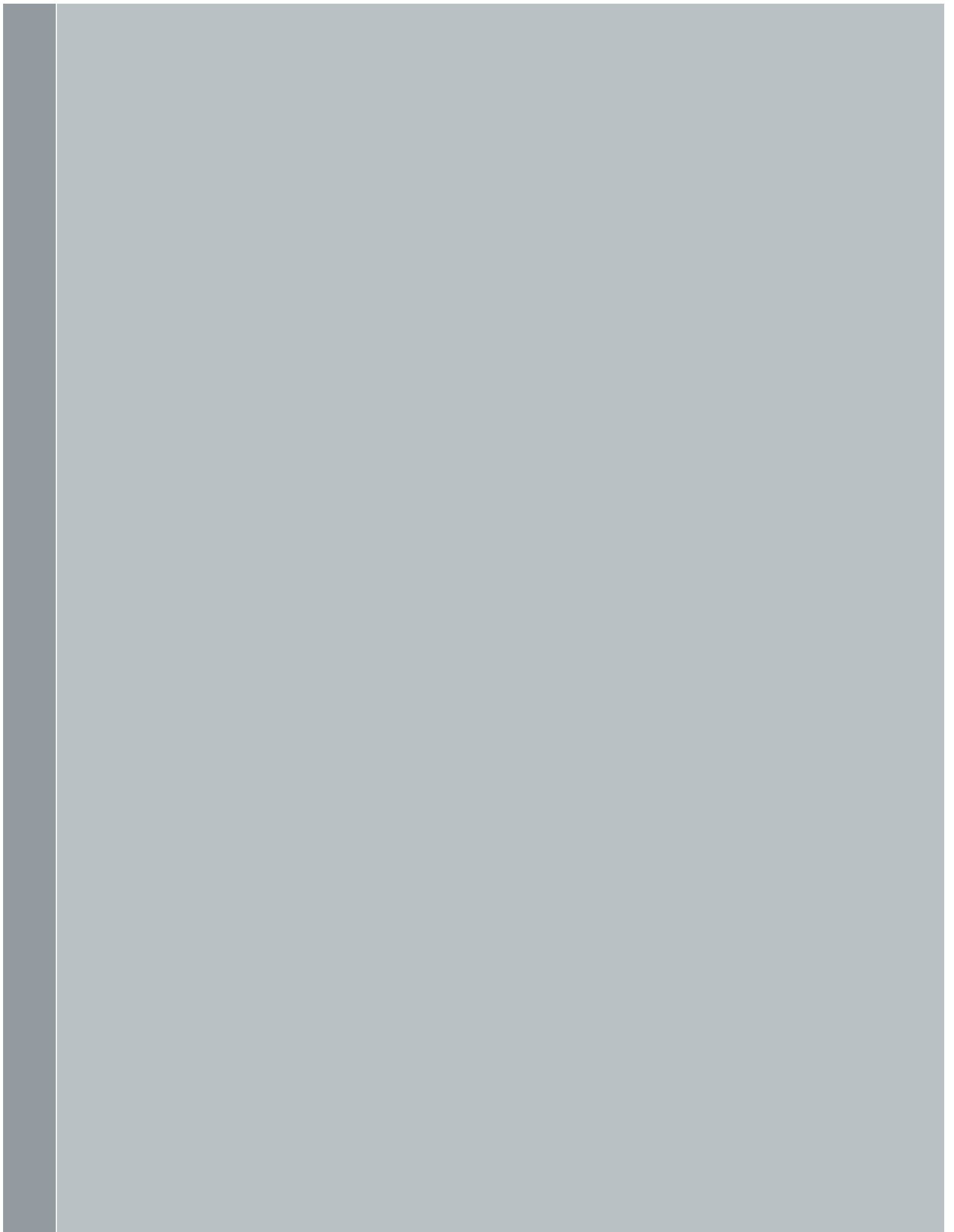




LONG TERM CARE
INSURANCE

2007 Federal and State Tax Guide



Introduction

This brochure presents an overview of the rules and regulations concerning the deductibility of tax-qualified long term care insurance (LTCI). It addresses the tax deductibility or exclusion of premiums paid, and the exclusion of benefits from Adjusted Gross Income (AGI).

We have also included examples of how tax-qualified LTCI premiums are treated, to provide you with guidance relevant to your clients' particular situations.

This is an interpretation of the Federal and State Tax Guidelines by John Hancock's Corporate Law Department. Clients should consult with their legal tax advisor regarding tax issues.



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Individual Purchase

Tax-qualified LTCI premiums are considered a medical expense. For an individual who itemizes income tax deductions, medical expenses are deductible to the extent that they exceed 7.5% of the individual's Adjusted Gross Income (AGI). The amount of the LTCI premium treated as a medical expense is limited to the eligible long term care insurance premiums, as defined by Internal Revenue Code¹ 213(d), based on the age of the insured individual. That portion of the LTCI premium that exceeds the eligible long term care insurance premiums is not includable as a medical expense. Table 1 illustrates the allowable deductions:

Table 1

Age of Insured Before the Close of the Year	2007 LTCI Eligible Premium Deduction
Ages 40 or Less	\$290
Ages 41 to 50	\$550
Ages 51 to 60	\$1,110
Ages 61 to 70	\$2,950
Ages Over 70	\$3,680

The 2007 per diem limitation under section 7702B(d)(4), regarding periodic payments received under a qualified long term care insurance contract, is \$260.

Example

Basic Information	
Age of Individual	55
Adjusted Gross Income (AGI)	\$55,000
Medical Expenses (Excluding LTCI Premiums)	\$4,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Calculating the Deduction	
Eligible Premium Deduction (Table 1)	\$1,110
Total Medical Expenses	\$5,110 (\$4,000 Medical Expenses + \$1,110 of Eligible LTCI Premiums)
7.5% of AGI	\$4,125
Medical Expenses that Exceed 7.5% of AGI	\$985 (\$5,110 - \$4,125)
Total Deduction	\$985
AGI Less Deduction	\$54,015 (\$55,000 - \$985)

1. Internal Revenue Code will be listed as "IRC," followed by the section numbers.

If an individual purchases tax-qualified LTCI on behalf of a parent who is not a dependent, he/she is not entitled to a medical expense deduction. A dependent is generally someone for whom at least 50% of financial support is provided by the taxpayer.

Generally, benefits received from a tax-qualified LTCI policy that was purchased by an individual are non-taxable and therefore excluded from Adjusted Gross Income.

Self-Employed

A self-employed individual can deduct 100% of his/her out-of-pocket long term care insurance premiums, up to the age-based Eligible Premium amounts listed in Table 1 [IRC 162(l)]. The portion of LTCI premiums that exceeds the Eligible Premium amount is not deductible as a medical expense. The deductible amount includes eligible premiums paid for spouses and dependents [IRC 162(l)]. It is not necessary to meet a 7.5% AGI threshold in order to take a deduction.

However, a self-employed individual may not deduct LTCI premiums during any calendar month in which he/she or his/her spouse is eligible to participate in a subsidized health plan. A subsidized LTCI plan is one for which an employer pays part or all of the premiums for LTCI. Under our interpretation of Code Section 162(l)(2)(B), any month in which a self-employed individual is eligible to participate in a LTCI plan that is fully- or partially-paid by the self-employed individual's or his/her spouse's employer, the self-employed individual is not eligible to take the self-employed insurance deduction for eligible LTCI premiums paid under any LTCI plan.

Example

Basic Information	
Age of Self-Employed Individual	55
Gross Income	\$60,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Calculating the Deduction	
Eligible Premium Deduction (Table 1)	\$1,110
Gross Income Less Deduction	\$58,890 (\$60,000 - \$1,110)

Generally, benefits received from a tax-qualified LTCI policy that was purchased by an individual are non-taxable and therefore excluded from Adjusted Gross Income.

Partnership

Limited Liability Company (LLC)

Subchapter S Corporation

Partners in a partnership, members of an LLC that is taxed as a partnership, and shareholders/employees of Subchapter S Corporations who own more than 2% of the Corporation², are taxed as self-employed individuals. The partnership, LLC, or Subchapter S Corporation pays the premium. The partner, member, or shareholder/employee includes the LTCI premium in his/her Adjusted Gross Income, but may deduct up to 100% of the age-based Eligible Premium amount, as listed in Table 1³. It is not necessary to meet a 7.5% AGI threshold in order to take a deduction.

If the sole shareholder/employee purchases LTCI in his/her own name instead of that of the S Corporation, the S Corporation is not treated as a partnership and the shareholder is not treated as a partner. As such, the shareholder is not treated as self-employed and is only eligible to include his/her eligible LTCI premiums in his/her itemized deductions, which are subject to the 7.5% AGI threshold.

Example

Basic Information	
Age of Partner	55
Gross Income	\$60,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Calculating the Deduction	
Eligible Premium Deduction (Table 1)	\$1,110
Gross Income Less Deduction	\$58,890 (\$60,000 - \$1,110)

Generally, benefits received from a tax-qualified LTCI policy that was purchased by an individual are non-taxable and therefore excluded from Adjusted Gross Income.

2. IRC Section 1372 states that a more than 2% shareholder/employee is generally treated as a partner in a partnership, rather than as an employee, when it comes to fringe benefits. The deduction hinges on the more than 2% shareholder/employee being treated as a partner and self-employed by participating in a plan in which the employer pays the policy's premiums. [IRC162(l); Rev. Rul. 91-26].
3. [IRC 162(l)].

Subchapter C Corporation

Employer

When a business purchases a John Hancock tax-qualified LTCI policy on behalf of any of its employees, or their spouses and dependents, the corporation is entitled to take a 100% deduction as a business expense on the total premiums paid⁴. The deduction is not limited to the age-based Eligible Premium amounts listed in Table 1 [IRC 162(a)].

The purchase of a tax-qualified LTCI policy is not subject to any nondiscrimination rules, thus allowing an employer to be selective in the classification of employees it elects to cover (e.g., a select group of officers).

Employee⁵

The entire LTCI premium amount paid by the business is excluded from the employee's Adjusted Gross Income, even if the premium exceeds the Eligible Premium amount listed in Table 1⁶. This exclusion applies to shareholders/employees in a Subchapter C Corporation and to shareholders/employees who own 2% or less of the corporation in a Subchapter S Corporation.

Example

Basic Information	
Premium Paid by Subchapter C Corporation	\$20,000 (\$2,000 premium x 10 individuals)
Calculating the Deduction	
Total Deduction	\$20,000
Calculating the Exclusion	
Amount Excluded from Each Employee's Taxable Income	\$2,000

Generally, premiums paid by the employer and benefits received under an employer-purchased tax-qualified LTCI policy are non-taxable and therefore excluded from the employee's Adjusted Gross Income [IRC 7702B, 104(a)(3)].

4. [IRC 162(a)].

5. For LTCI coverage provided by a closely-held C Corporation, the IRS can challenge tax benefits claimed under an employer-provided plan that covers only shareholders/employees, if they find that the plan is not for employees.

6. [IRC 106, 7702B, 104(a)(3)].

Employer-Pay Contributory Arrangement on Behalf of an Employee

If an employer pays all or a portion of the tax-qualified LTCI premiums on behalf of an employee, the amount paid is deductible by the employer as a business expense⁷. The deductions are not limited by the age-based limits on Eligible Premium listed in Table 1. [IRC 162(a)]. The entire employer contribution would also be excluded from the employee's AGI.

If the employer only pays a portion of the premium, the employee is able to apply the balance that he/she pays towards his/her medical expenses, up to the Eligible Premium amount, and would then be entitled to a deduction for medical expenses that exceed 7.5% of AGI.

Example: Employee Deduction

Basic Information	
Age of Individual	55
Adjusted Gross Income (AGI)	\$55,000
Medical Expenses (Excluding LTCI Premiums)	\$6,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Employer Contribution	\$500
Premium Paid by Employee	\$1,500
Calculating the Deduction	
Eligible Premium Deduction (Table 1)	\$1,110
Total Medical Expenses	\$7,110 (\$6,000 medical expenses + \$1,110 of eligible LTCI premiums)
7.5% of AGI	\$4,125
Medical Expenses that Exceed 7.5% of AGI	\$2,985 (\$7,110 - \$4,125)
Total Deduction	\$2,985
AGI Less Deduction	\$52,015 (\$55,000 - \$2,985)

7. [IRC 162 (a)].

Example: Employer Deduction

Basic Information	
Premium Paid by Employer	\$500
Calculating the Deduction	
Total Deduction as a Business Expense	\$500

Generally, premiums paid by the employer and benefits received under an employer-purchased tax-qualified LTCI policy are non-taxable and therefore excluded from the employee's Adjusted Gross Income [IRC 7702B, 104(a)(3)].

Gift Tax Exclusion

In addition to the annual Gift Tax Exclusion of \$12,000 per donee, a donor has the ability to pay for the medical expenses of the donee⁸. If those medical expenses are tax-qualified LTCI premiums, the exclusion is subject to the age-based limits for Eligible Premium amounts listed in Table 1. An individual (donor) can purchase LTCI policies for family members (donees) and still maintain the annual Gift Tax Exclusion and choose either John Hancock's Ten-Pay or Accelerated Payment Option. If the donor pays more than the eligible premium that applies to the donee, that amount will impact the annual \$12,000 Gift Tax Exclusion. If the donor pays less than the eligible premium, it will not impact the \$12,000 Gift Tax Exclusion.

Example

Basic Information	
Annual Gift Tax Exclusion	\$12,000
Age of LTCI Policy Recipient (Donee)	55
Annual Premium for Tax-Qualified LTCI Policy (Paid by Donor)	\$1,500
Calculating the Exclusion	
Eligible Premium Deduction (Table 1)	\$1,110
Premium Amount that Would Impact the Annual Gift Tax Exclusion	\$390 (\$1,500 - \$1,110)
Amount that Donor Could Still Give Donee Under the Annual Gift Tax Exclusion	\$11,610 (\$12,000 - \$390)

8. [IRC Sec. 2503(e)].

Return of Premium

The refund is included in the beneficiary's gross income and is taxable, to the extent it was either excluded from the owner's income or deducted by the owner. It must be included in income the year it is received.

Health Savings Account (HSA)

Tax-qualified LTCI premiums can be reimbursed through an HSA, tax-free, up to the Eligible Premium amounts listed in Table 1, even if the HSA is offered through an employer-provided cafeteria plan.

Health Reimbursement Account (HRA)

Reimbursements for insurance covering medical care expenses, as defined in IRC Sec. 213(d), which includes qualified long term care services and qualified long term care insurance premiums, are allowable under an HRA. Although employers pay for HRAs, an HRA cannot be provided by salary reduction or IRC Sec. 125 plans. As such, the LTC premiums cannot be paid on a pre-tax basis through an HRA.

Cafeteria Plan

Tax-qualified LTCI policies cannot be purchased with pre-tax dollars under an employer-provided cafeteria plan. However, LTCI premiums may be paid through an HSA that is offered under an employer-provided cafeteria plan.

Flexible Spending Account (FSA)

Tax-qualified LTCI premiums cannot be reimbursed under an FSA.

State Tax Incentives

State	Credit/ Deduction	Summary
Alabama	Deduction	Allows for an itemized deduction for premiums paid for qualified long term care coverage under a policy that meets the requirements in Alabama. Qualified LTC premiums are not included in medical expenses.
Alaska	None	
Arizona	Deduction	Allows for an itemized medical expense deduction for premiums paid for qualified long term care coverage which are reduced by medical expenses allowed to be taken as a federal itemized deduction.
Arkansas	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
California	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Colorado	Credit	Allows for a state income tax credit equal to the lesser of 25% of premiums paid or \$150 per policy. The credit is available only to individual taxpayers with federal taxable income of less than \$50,000 (or two individuals filing jointly and claiming credit for one policy) and individuals filing jointly with \$100,000 claiming a credit for two policies. Unused credit may not be carried forward or refunded.
Connecticut	None	
Delaware	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
District of Columbia	Deduction	An individual may deduct from gross income the amount the individual pays annually in premiums for long-term care insurance, as defined in § 31-3601(5); provided, that the deduction shall not exceed \$500 per year, per individual, whether the individual files individually or jointly.
Florida	None	
Georgia	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Hawaii	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.

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State	Credit/ Deduction	Summary
Idaho	Deduction	Allows for individual taxpayer to deduct full amount of premiums paid, to the extent the premiums have not otherwise been deducted or accounted for by the taxpayer for Idaho income tax purposes, for the taxpayer, a dependent, or an employee.
Illinois	None	The LTCI premium deduction expired at the end of 2004.
Indiana	Deduction	Allows for a deduction of eligible premium for an individual taxpayer or spouse for Indiana Partnership policies only. For self-employed individuals, the deduction is reduced to the extent the deduction is taken on the federal return.
Iowa	Deduction	Allows for an itemized medical and dental expense deduction to the extent allowed for federal income tax purposes.
Kansas	Deduction	Allows for a deduction from federal adjusted gross income for premiums paid up to \$600 for 2006 (\$1,200 for married filing jointly). The deduction is increased by \$100 each year to a maximum of \$1,000.
Kentucky	Deduction	Allows for a deduction from federal adjusted gross income on any amount paid for long term care premiums as defined by Kentucky code.
Louisiana	None	
Maine	Credit/Deduction	Allows employers providing benefits to employees a credit for the lesser of: (1) \$5,000; (2) 20% of costs incurred for this benefit; or (3) \$100 for each covered employee. Allows an individual taxpayer to take a state income tax deduction equal to total premiums paid less any amount claimed as a deduction for federal income tax purposes.
Maryland	Credit	Allows an individual taxpayer to take a credit for 100% of eligible premiums paid for self, spouse, parents or children, up to a \$500 per person cap. Allows employers providing benefits to employees a credit for the lesser of: (1) \$5,000; (2) 5% of costs incurred for this benefit; or (3) \$100 for each covered employee. Applies to sitused employer groups only.
Massachusetts	Deduction	Allows for itemized medical expense deduction to the extent allowed for federal income tax purposes.

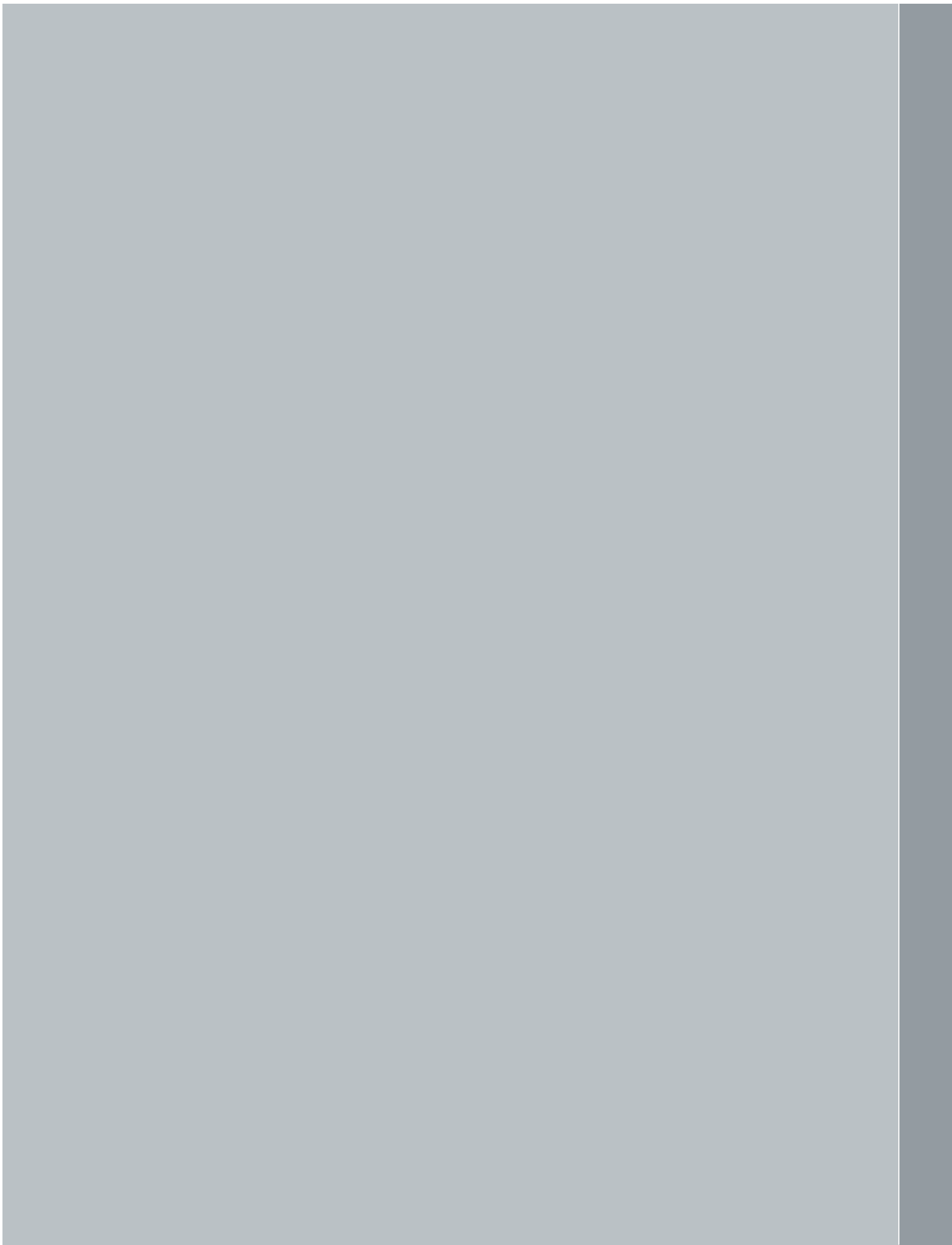
State	Credit/ Deduction	Summary
Michigan	None	
Minnesota	Credit/Deduction	Allows for a tax credit for premiums paid equal to the lesser of: (1) 25% of premiums paid to the extent not deducted in determining federal taxable income; or (2) \$100 (\$200 a year if married and filing jointly). Deduction is also allowed to the extent premiums are not used to claim credit.
Mississippi	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Missouri	Deduction	Allows for a state tax deduction equal to 50% of unreimbursed premiums paid to the extent not included in individual itemized deductions.
Montana	Credit/Deduction	Allows for a limited credit for expense of caring for elderly family members (includes premiums for long term care insurance). Credit is determined based on taxpayer's Adjusted Gross Income and cannot exceed \$5,000 per qualifying family member in a taxable year (\$10,000 for two or more family members). Allows for a deduction for all premiums paid by the taxpayer, except premiums that are deducted in determining Montana adjusted gross income or for which a credit is allowed under Montana law, for policies or certificates that provide coverage for taxpayer, spouse, parents or grandparents.
Nebraska	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Nevada	None	
New Hampshire	None	
New Jersey	Deduction	Allows for deduction for medical expenses only to the extent such expenses exceed 2% of New Jersey gross income.
New Mexico	Credit/Deduction	Allows individual taxpayers 65 and older and not dependent to claim a credit of \$2,800 for medical care expenses (including long term care premiums) paid for the taxpayer, spouse, or dependents if expenses equal \$28,000 or more within a taxable year and if expenses are not reimbursed or compensated. Allows for deduction as part of unreimbursed or uncompensated medical care expenses. Total medical expense deduction is limited based on income level.

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State	Credit/ Deduction	Summary
New York	Credit	Allows a tax credit equal to 20% of premium paid during the taxable year.
North Carolina	Credit	Allows for itemized medical expense deduction to the extent allowed for federal income tax purposes.
North Dakota	Credit	Allows a tax credit equal to 25% of premium paid during the taxable year for taxpayer, spouse, parent, or stepparent, not to exceed \$100 per each insured individual.
Ohio	Deduction	Allows for a deduction for unreimbursed premiums paid for individual taxpayer, spouse, and dependents, to the extent not allowed in computing federal or Ohio Adjusted Gross Income.
Oklahoma	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Oregon	Credit	<p>Allows a tax credit equal to the lesser of 15% of premium paid during the taxable year or \$500 if the policy also covers dependents or parents. Taxpayers must add premiums to Oregon income to the extent they were deducted on federal return.</p> <p>Allows employers a credit for Oregon-based employees equal to the lesser of 15% of the total amount of long term care insurance premiums paid or incurred during the tax year or \$500 multiplied by the number of employees covered.</p> <p>Unused credits may not be carried over.</p>
Pennsylvania	None	
Rhode Island	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
South Carolina	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
South Dakota	None	
Tennessee	None	
Texas	None	

State	Credit/ Deduction	Summary
Utah	Deduction	Allows for a deduction of all premiums for all resident and nonresident taxpayers to the extent the amount was not deducted in determining federal taxable income.
Vermont	Deduction	Allows for an itemized medical expense deduction to the extent allowed for federal income tax purposes.
Virginia	Credit/Deduction	<p>Allows for a credit equal to 15% of premiums paid by individual not to exceed over the life of any policy 15% of the amount of premiums paid for the first 12 months of coverage. If credit exceeds individual income tax liability for the tax year, excess can be carried over for credit for next 5 years or until credit is used.</p> <p>Allows for a deduction, from federal adjusted gross income in calculating Virginia taxable income, for premiums not claimed on federal tax return or a credit for the premiums.</p>
Washington	None	
West Virginia	Deduction	Allows for a deduction, from federal Adjusted Gross Income in calculating West Virginia taxable income, for premiums paid for taxpayer, spouse, parent, or dependent, only to the extent the amount is not allowable as a deduction when arriving at taxpayer's federal adjusted gross income.
Wisconsin	Deduction	Allows for a subtraction from federal Adjusted Gross Income a portion of the amount of premiums paid for taxpayer and spouse when computing Wisconsin taxable income.
Wyoming	None	

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