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LONG-TERM CARE TAX BREAKS

By Victor Sy, CPA, MBA

The Health Insurance Portability and Accountability Act (the Health Insurance Act) gives tax breaks for individuals who want to set up long-term care plans. As baby boomers and yuppies age, the related-tax issue of aging and long-term care will receive more attention.

Let us explore this new plan that allows you to [deduct the costs of insurance premiums and expenses](#) as well as its income and gift tax implications:

1. Long-term care insurance policies to qualify must cover only qualified long-term care services.
2. They have to be guaranteed to be renewable.
3. They must have no cash value. Refunds and dividends must be used only to reduce future premiums or increase future benefits.
4. Qualifying long-term care services include necessary diagnostic and preventive care as well as therapy, rehabilitation, and treatment. They also include maintenance and personal care services for chronically ill individuals as long as licensed health care practitioners prescribe these.
5. A qualifying insurance policy must not cover expenses eligible for Medicare reimbursements.
6. These new tax breaks cover insurance policies that were issued after 1996 but pre-existing policies meeting insurance standards are also eligible. Ineligible existing policies should have been exchanged for qualifying policies.
7. Payments for insurance policies will be treated as health insurance deductions for Federal income tax purposes. Individuals can deduct the premiums as itemized medical expenses. The annual maximum deductions for premiums increase with age from \$340 for age 40 up to \$4,240 for age 71 and over (It is your age by December 31 that counts).
8. You can also deduct long-term insurance premiums for your spouse and even relatives who receive more than 50% of their support from you (dependents).
9. Benefits are 100% tax-free if paid under an expense-reimbursement policy. If the policy provides periodic benefits regardless of actual expenses, payments up to \$300 for 2011 (\$310 for 2012) per day are tax-free.
10. Self-employed individuals owning more than 2% of businesses or S corporations can deduct 45% to 80% of premiums.
11. Employers can also provide qualifying long-term care benefits as a fringe benefit. The employer can deduct the premiums while the employee does not have to recognize the corresponding income.

12. Insured long-term coverages are nondiscriminatory, that is, benefits can be provided to owners and selected employees only. (However, nondiscrimination rules apply when the plans are self-insured).
13. Unreimbursed long-term care expenses are deductible as medical expenses. They are written off as medical expenses and, therefore, subject to the 7.5% floor of adjusted gross income.
14. There are no gift tax consequences and you can make unlimited direct payments to care providers for most relatives receiving more than 50% of their support from you. There are no gift tax consequences whether payments are made directly to care providers or to insurance companies. (However, if payments are made outside those two, the usual \$10,000 annual limit on tax-free gifts applies and payments over that threshold become subject to gift taxes).

In conclusion, this tax break is one of the most significant features of the Health Insurance Act and is wonderful for individuals who are about to retire or who can afford to contribute now but expect financial problems when it is time to retire.