John Hancock Tax-Qualified Long-Term Care Insurance Tax Information 2004

John Hancock Life Insurance Company
Boston, Massachusetts 02117

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Introduction

John Hancock Tax-Qualified Long-Term Care Insurance Tax Information

An overview of the rules and regulations concerning the deductibility of tax-qualified (TQ) long-term care insurance. It addresses both the tax deductibility or exclusion of premiums paid and the exclusion of benefits.

Examples for the Individual Purchase, Self-employed, Partnership and Subchapter S Corporations, Subchapter C Corporations, Cafeteria Plans, Limited Liability Companies (LLC) and Contributory Arrangements have been developed to assist you in the understanding of how TQ Long-Term Care Insurance premiums are treated.

John Hancock Tax-Qualified
Long-Term Care Insurance
Tax Information

LTC insurance premiums are considered a medical expense. The amount of the premium treated as a medical expense is limited to the "Eligible Premium," per Internal Revenue Code* 213(d), based on the age of the insured individual, in accordance with the following chart:

Table 1

Age of insured before the close of the year	2004 Eligible Premium Deduction
Ages 40 or Less	$260
Ages 41 to 50	$490
Ages 51 to 60	$980
Ages 61 to 70	$2,600
Ages over 70	$3,250

For people who itemize income tax deductions, medical expenses are deductible to the extent they exceed 7.5% of adjusted gross income (AGI).

Example

Individual Deduction

A 55-year-old individual owns a TQ John Hancock long-term care insurance policy with an annual premium of $2,000. The deductible component is the amount of eligible premium ($980). Medical expenses of $6,000 (includes the $980 of eligible LTC Insurance Premium). Adjusted Gross Income is $55,000.

Eligible Premium Deduction (EPD) $980 **(Table 1)**

Medical Expenses = $6,000 (Including Eligible LTC Insurance Premium).
7.5% of AGI = $4,125 ($55,000 x 7.5%)

Allowable Deduction for Medical Expenses = $1,875 ($6,000 - $4,125).
Total Deduction = $1,875

That portion of the LTC insurance premium that exceeds the "eligible premium" as determined in Table 1 (in this example, $1,020) is not deductible as a medical expense.

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

Benefits

Benefits received under a tax-qualified long-term care insurance policy purchased by an individual will be excluded from gross income.

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

Self-Employed

John Hancock Tax-Qualified Long-Term Care Insurance Tax Information

A self-employed individual in 2004 can deduct 100% of his/her out-of-pocket *health insurance premiums* (not 100% of out-of-pocket *medical expenses*) in arriving at their Adjusted Gross Income (AGI). [IRC 162(l)]. The full 100% is available whether or not the individual itemizes deductions. In the case of a tax-qualified LTC insurance policy, the 100% self-employed deduction is limited to the "eligible premium" (Table 1). The deductible amount includes eligible premiums paid for spouses and dependents. [IRC 162(l)].

Example

Self-Employed Deduction

The percentage of medical expenses that is deductible, for tax-qualified long-term care insurance, by self-employed persons, without regard to the 7.5% floor, is as follows:

A self-employed 55-year-old person owns a Tax Qualified long-term care insurance policy with an annual premium of $2,000. The age-based eligible premium is $980. As a self-employed person, he/she can deduct 100% of the eligible premium, or $980.

That portion of the LTC insurance premiums that exceeds the eligible premium, as determined in table 1 on the previous page, is not deductible as a medical expense.

Partnership/S Corporation/ Limited Liability Company

John Hancock Tax-Qualified
Long-Term Care Insurance
Tax Information

Partners in a partnership and members of a Limited Liability Company that is taxed as a partnership are self-employed. The partnership or LLC pays the premium. The partner or member includes the premium in his or her gross income, but may deduct 100% of the eligible premium. [IRC 162(l)].

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(1): Rev. Rul. 91-26].

Example

Partnership Deduction

Partner A - 50% partner
A 55-year-old owns a TQ John Hancock long-term care insurance policy with an annual premium of $2,000.

Self-Employed Deduction (Step 1)
$980 x 100% = $980 [Eligible LTC Premium (Table 1)

Adjusted Gross Income (AGI)
$52,000 - $980 = $51,020 (Gross Income – Deduction).

Benefits

All long-term care insurance benefits paid to the policyholder will be income tax free.

John Hancock Tax-Qualified
Long-Term Care Insurance
Tax Information

When a Business purchases a TQ John Hancock LTC insurance policy on behalf of any of its employees, the employee's spouse or dependents, as part of an accident and health employee benefit plan, the corporation is entitled to a full deduction as a business expense on the entire premiums paid. [IRC 162(a)]. The deduction is not limited to the "eligible premium" component. Moreover, the entire amount paid by the Business is excluded from the employee's gross income, even if the premium exceeds the eligible premium. [IRC 106, 7702B, 104(a)(3)]. This exclusion applies to shareholder/employees in a subchapter C Corporation and to shareholders/employees in an Subchapter S Corporation who own 2% or less of the corporation.

The purchase of a tax-qualified long-term care insurance 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).

Example

C-Corp Deduction

A Subchapter C Corporation purchases a TQ John Hancock LTC insurance policy on behalf of one of its employees who is 55 years old.

Premium paid by C Corporation: $2,000

C Corporation tax deduction: $2,000

Excluded from taxable income of employee: $2,000

Benefits

Benefits paid out under an employer-purchased qualified LTC insurance policy will be excluded from the employee's gross income and therefore non-taxable. [IRC 213(d), 7702B, 104(a)(3)]. The income exclusion also applies to the premium paid by the employer.

Cafeteria Plans

Qualified LTC insurance cannot be purchased with pre-tax dollars under an employer-provided cafeteria plan. Similarly, tax-qualified long-term care insurance premiums cannot be reimbursed under a flexible spending account.

Employer Pay Contributory Arrangement on Behalf of an Employee

John Hancock Tax-Qualified Long-Term Care Insurance Tax Information

If an employer pays all or a portion of the tax-qualified LTC insurance premiums on behalf of an "employee," the amount paid is deductible by the employer as a business expense. [IRC 162(a)]. The deductions are not limited by the age-based limits on premium for individual deductions.

Example

Employer Deductions

A 65-year-old purchased a TQ John Hancock LTC insurance policy with an annual premium of $2,000, and has medical expenses of $6,000 (excluding the LTC insurance premium). Adjusted Gross Income (AGI) is $55,000.

If the employer paid $500 of the $2,000 long-term care insurance premium, the employer would be able to deduct the $500 as a business expense. The entire employer contribution would be excluded from the employee's gross income.

The employee is able to apply the balance he/she paid ($1,500) up to the eligible premium towards his/her medical expenses and would then be entitled to a deduction for medical expenses of $3,375 ($6,000+$1,500) - (7.5% of $55,000).

Benefits

Employer can take a deduction for the total portion of the premium paid.

Employee can only deduct the eligible premium as a medical expense.

Gift Tax Exclusion

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Long-Term Care Insurance
Tax Information**

LTC insurance premiums can be included in qualifying medical expenses for the annual Gift Tax Exclusion. An Individual could move a significant amount of money out of his/her estate by purchasing LTC insurance policies for others and choosing John Hancock's 10-pay or paid-up-at-age-65 payment options. In addition to the regular annual Gift Tax Exclusion or $11,000 per donee, a donor has an unlimited Gift Tax Exclusion for payment by the donor of medical expenses of the donee per IRC Sec. 2503(e). In the case of a qualified LTC insurance policy, the medical expense Gift Tax Exclusion is limited to the eligible premium. Qualifying medical expenses also include qualified LTC services as mentioned above as long as payments go directly to the provider of care and not to the individual. The provider can be any person, subject to a possible exception for a family member.

(Please refer to Table 1 on page 2 of this booklet, for eligible long-term insurance care premiums for 2004.)

Example

To illustrate this planning point, assume the parent is 55 and is interested in acquiring a tax-qualified long-term care insurance policy from John Hancock. The child plans to pay the entire premium directly to John Hancock. Depending on underwriting and the policy's benefits, the annual premium could be more or less than $980, the eligible premium limit. If the premium is $980 or less, the child could pay the entire premium and still preserve the full amount of the regular $11,000 annual exclusion for other gifts to the parent. On the other hand, if the premium exceeds $980, the excess could qualify for the annual Gift Tax Exclusion, but would now be subject to the regular $11,000 annual exclusion.

Benefits

Individuals can purchase LTC insurance policies for family members and still maintain the annual Gift Tax Exclusion

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