



Genworth®  
Financial



## TAX-QUALIFIED LONG TERM CARE INSURANCE

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call the Genworth Advanced  
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### 2008 TAX INFORMATION

Underwritten by  
Genworth Life Insurance Company, and in New York,  
by Genworth Life Insurance Company of New York



# INDEX

General . . . . . Page 2

Individual Taxpayer . . . . . Page 5

Self-Employed Taxpayer . . . . . Page 6

C Corporation and Not-for-Profit Organizations . . . . . Page 8

Partnership . . . . . Page 9

Limited Liability Company (LLC) . . . . . Page 10

S Corporations . . . . . Page 12

Contributory Arrangements . . . . . Page 14

Health Savings Accounts and LTC Insurance . . . . . Page 16

Changes to “Grandfathered/Tax Qualified” LTC Insurance Policies . . . . . Page 18

Appendix (summary of state LTCL tax credits and deductions) . . . . . Page 19

## GENERAL

This page contains general information applicable to most Long Term Care Insurance (LTCI) premium taxation questions, and disclaimers and qualifications on information that this guide covers.

### Qualified Premiums

Only “qualified” LTCI premiums are considered a deductible medical expense (Internal Revenue Code (IRC) §213(d)). Qualified LTCI premiums are premiums that do not exceed the age-based limits shown below. Premiums exceeding these limits are “non-qualified” and are not a deductible medical expense (IRC §213(d)). These limits are adjusted annually for inflation.

### AGE-BASED LONG TERM CARE INSURANCE PREMIUMS

Age at End of Taxable Year	Premium Limit 2008 Amount
40 or less	\$310
41 through 50	\$580
51 through 60	\$1,150
61 through 70	\$3,080
71 and older	\$3,850

### Alternate Minimum Tax

The discussion in this guide and examples do not consider the effect of the Alternate Minimum Tax imposed on certain taxpayers by IRC §55. You should encourage customers who expect to owe this tax to consult with a qualified tax advisor before they take itemized deductions.

### Limited pay premiums

Many LTCI policies offer the option of paying premiums for a limited time or until a certain date, after which the policy is paid up. It is not certain that the entire amount paid is deductible in the year paid. One approach may be to amortize any deductibility to which the premium payor may be entitled over the insured’s life expectancy. Customers must consult with their tax advisors.

### Return of Premiums

Qualified LTCI policies cannot provide for a cash surrender value or other money that can be borrowed, paid, pledged or assigned as collateral for a loan (IRC §7702B(b)(1)(D)). Premium refunds, policy dividends or similar amounts must be applied to reduce future premiums or increase future benefits (IRC §7702B(b)(1)(E)).

There are two exceptions to this general rule:

- Premium refunds paid on the insured’s death are generally not taxable income to the policyowner’s estate or beneficiary (IRC §7702B(b)(2)(C)).
- Premium refunds paid on a complete surrender or cancellation of the policy must be included in the taxpayer’s gross income to the extent that the taxpayer was allowed a deduction or exclusion for the premium payments (IRC §7702B(b)(2)(C)).

This is federal law. Customers should seek advice from their tax advisor regarding any potential state tax liability associated with a LTCI policy premium refund where the taxpayer has received a deduction or credit under state law.

### Jointly Owned Policies

Two people may jointly own a shared benefit LTCI policy insuring their joint lives. However, the IRS has not provided clear guidance on LTCI premium deductibility in that situation. We believe that it is reasonable for a husband and wife, filing jointly, to deduct from their combined income the lesser of the actual premiums paid or their combined age-based limit premiums. However, the customers will need to seek independent tax advice on this question.

For example, John and Mary are ages 71 and 61 respectively. They are married and file jointly. They jointly own and are the joint insureds under a shared benefit Genworth Life Insurance Company LTCI policy with \$8,000 annual premiums. For 2008, their combined age-based limit premiums will be \$6,930 (\$3,080 + \$3,850). We believe that they may deduct \$6,930 as a medical expense to the extent that this expense and all other medical expenses not paid for by insurance exceed 7.5% of their combined AGI.

### HSA

Money saved in an HSA may be used to help pay LTCI premiums. See the discussion on page 16 of this guide for details.

### Other Employer-Sponsored Benefit Plans

Long term care insurance cannot be offered as part of a cafeteria plan (IRC §125(f)). Nor can premium payments for tax qualified LTCI premiums be reimbursed tax-free from a Flexible Spending Account (IRC §106(c)).

### Non-Discrimination

Generally, employers may provide LTCI benefits on a discriminatory basis. However, there may be exceptions, especially for plans that discriminate in favor of a business' owners. Employers must consult with their legal and tax advisors to determine if a proposed plan providing LTCI benefits violates any nondiscrimination provisions.



## GENERAL (CONT.)



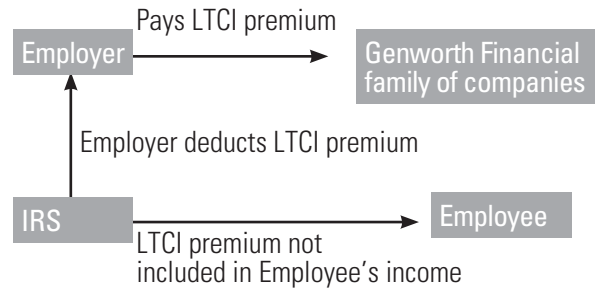
### Federal Income Tax Treatment of Premiums Paid by an Employer for Employee-owned LTCI Policy

Employees are not taxed on premiums paid by their employer for LTCI policies owned by the employee, the employee's spouse, and the employee's eligible dependents (as defined by IRC §152), even if the premiums exceed the age-based limits discussed on page 2 of this guide (IRC §106(a)). Generally, the employer may deduct such premiums from income (IRC §162), even premiums in excess of the age-based limits. An eligible dependent is someone who depends on the taxpayer for at least half their annual support (IRC §152). Generally, if the taxpayer can claim the person as a dependent on their 1040 return, they are an eligible dependent.

The employer's deduction is allowed for amounts paid for personal services rendered by the employee to the employer, and when the total amount paid to the employee, including LTCI premiums, does not represent unreasonable compensation (IRC §162(l) and Rev. Rul. 58-90, 1958-1 C.B. 88).

If the employer is directly or indirectly a beneficiary under the policy, the employer's deduction will be denied (Rev. Rul. 58-90, 1958-1 C.B. 88).

### EMPLOYER PAYING PREMIUMS FOR EMPLOYEE



*This chart applies to all employer/employee relationships, and to S Corporations and their 2% or less stockholders.*

### Federal Income Tax Treatment of Benefits Paid

Benefits paid under a qualified LTCI policy are treated as reimbursements for medical care, and are excluded from the policyowner's income (IRC §105(b)).

### State Income Tax Deductions and Credits

Many states offer an income tax deduction or credit for LTCI premiums paid. See the appendix to this guide for a list of which states offer a deduction or credit. It is important that customers speak with a tax advisor to determine if they may take a deduction or credit.

### Per Diem Limit

The per diem limit on long term care expenses for 2008 is \$270 (IRC §7702B(d) as adjusted for inflation). Daily benefits within this limit are federal income tax free to the LTCI policyowner.

Policy benefits received over a certain period of time, and which exceed this limit, are federal income tax free only to the extent that those same benefits are equal to or less than the amount the policyowner spent during the same period for their long term care.

## INDIVIDUAL TAXPAYER

Purchased by an individual on an after-tax basis

*Assumption:* Mary owns a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy with a \$3,500 annual premium. She is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000.

### Deduction for LTCI Premium

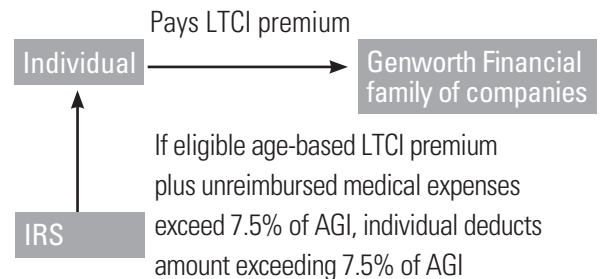
Although LTCI premiums for an individual taxpayer, his or her spouse and eligible dependents are deductible medical expenses (IRC §213(d)), Mary may deduct them (assuming she itemizes deductions) only up to the age-based limits (page 2), and then only to the extent that those premiums and all other medical expenses not paid by insurance or otherwise reimbursed to Mary exceed 7.5% of AGI (IRC §213(a)).

In 2008, Mary may deduct only \$3,080 of her \$3,500 LTCI premiums. \$3,080 is the lesser of her age-based limit and the actual premium she paid. To that amount she adds \$2,400 in medical expenses not covered by insurance for a total of \$5,480 in medical expenses.

Mary may deduct those medical expenses that exceed 7.5% of AGI. Her AGI is \$50,000. 7.5% of \$50,000 is \$3,750. She may therefore deduct \$1,730 from her taxable income (\$5,480 – \$3,750), assuming that she itemizes deductions.

Note that if Mary had not bought LTCI, she would not have had any deductible medical expenses because her other medical expenses totaled only \$2,400, less than 7.5% of AGI.

### INDIVIDUAL PAYING PREMIUMS FOR HIS OR HER OWN POLICY



## SELF-EMPLOYED TAXPAYER

Purchase by self-employed individual on an after-tax basis

*Assumption:* Mary owns a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy with a \$3,500 annual premium. She is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000.

### Deduction for LTCI Premium

A self-employed person may deduct eligible premiums for accident and health insurance, including LTCI premiums that they pay for themselves, their spouse and other eligible dependents. They need not consider the 7.5% of AGI threshold for deductibility of medical expenses (IRC §162(l)). Though often referred to as a deduction, this item is really an adjustment to income. It reduces a self-employed person's gross income, but does not reduce their net earnings subject to self-employment tax (IRC §162(l)(4)). Furthermore, to the extent that a self-employed person uses this adjustment to reduce income, the adjustment cannot be used to determine the amount the self-employed person may take as a medical expense deduction (IRC §162(l)(3)).

For the 2007 tax year, the adjustment is taken on line 29 of the 1040 return.

Mary's LTCI premium is \$3,500, but her eligible premium is \$3,080. She may deduct \$3,080 of her LTCI premium in 2008. Since she is self-employed, she may take this deduction without regard to whether this amount exceeds 7.5% of her AGI. The remaining \$420 of her LTCI premium is not considered a medical expense, and is not deductible.

Because she deducted \$3,080 of her LTCI premium from her income, her AGI is reduced by \$3,080 to \$46,920. Although she had \$2,400 in other medical expenses not covered by insurance, she may not deduct them because \$2,400 does not exceed 7.5% of her new AGI ( $\$46,920 \times 7.5\% = \$3,519$ ).

In this example, Mary is self-employed for the entire year. The "Self-Employed Health Insurance Deduction Worksheet" in IRS Publication 535 says Mary may not deduct LTCI premiums for any month she could participate in a long-term care insurance plan subsidized by her employer or her spouse's employer. (Even though she is "self-employed", she could still be an employee of another business). Note that it's only eligibility to participate that makes Mary lose this deduction; it is not important whether she actually participates.



The tax treatment discussed here results in greater deductibility for Mary than she would have had as an individual. Had Mary added the \$3,080 eligible LTCL premium to the \$2,400 she had in medical expenses not covered by insurance (\$5,480 in total), her deduction would be only 1,730 ( $\$5,480 - \$3,750 [7.5\% \times \$50,000]$ ), \$1,350 less than the deduction she may take as a self-employed person.

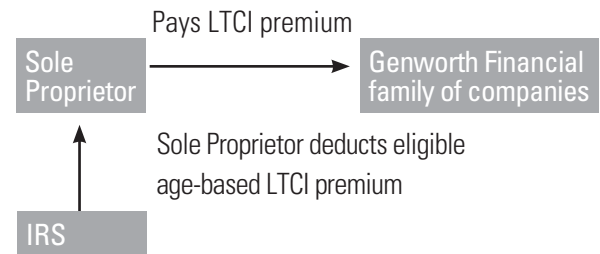
The 162(l) deduction is available even if the owner owns the LTCL contract in his or her own name rather than in the name of the business (ILM 200524001 dated 5/17/2005 as to medical insurance costs).

## Tax Strategies for Self-Employed Persons

### Self-Employed Spouse Pays Premiums for Policy Owned by Employee-Spouse

Many self-employed persons employ their spouse in their business. If the spouse is legitimately employed, the self-employed spouse may pay the premiums for a qualified LTCL policy owned by the employee/spouse, and deduct the premiums without regard to the age-based limits on page 2 (IRC §162). Nor does the employee/spouse include those premiums in income (IRC §106(a)). Note, however, that this strategy will not work with S Corporations (see page 13).

### SOLE PROPRIETOR PAYING PREMIUMS FOR HIS OR HER OWN POLICY



## C CORPORATION AND NOT-FOR-PROFIT ORGANIZATIONS

C Corporation employer pays premium on employee-owned LTCI policy. LTCI premiums paid for by a charity for its employees receive similar tax treatment to those provided by a C Corporation.

*Assumption:* ABC Corp is a C Corporation. It pays the \$3,500 annual premium for a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy Mary owns. Mary is 61 years old, and is an employee of ABC. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000, not counting the \$3,500 LTCI premiums ABC pays.

### Tax Treatment of Employer

Generally, a C Corporation may deduct all premiums it pays for accident and health insurance coverage (including premiums paid for tax qualified LTCI) for its employees, their spouses and eligible dependents (IRC §152) – even premiums in excess of the age-based limits on page 2 (IRC §162).

It may not deduct LTCI premiums paid for stockholders who are not employees, or for employees who are not actively participating in the corporation's business, unless that stockholder or inactive employee is also a spouse or eligible dependent of an active employee.

A C Corporation may deduct the LTCI premiums whether the coverage is provided under a group policy or under an individual policy. In our example, ABC Corp may deduct the full \$3,500 premium it pays for Mary's LTCI policy regardless of whether Mary is a non-owner employee or an owner/employee (even an owner/employee who owns 100% of the shares of ABC Corp).

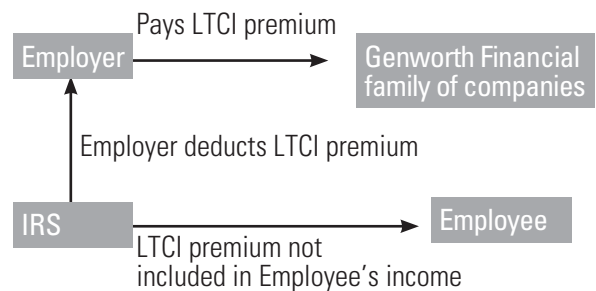
A plan may cover one or more employees, and there may be different plans for different employees or classes of employees. An accident and health plan may be either insured or noninsured. The plan does not have to be in writing nor does the employee's rights to benefits under the plan have to be enforceable (Regs. §§ 1.105-5, 1.106-1).

### Tax Treatment of Policyowner (owner or non-owner employee)

Mary would have no taxable income from the employer-paid LTCI premiums nor would any benefits she receives under the policy be taxable income to her. This applies whether Mary is a non-owner employee or an owner/employee, even an owner/employee who owns all the shares of the employer (IRC §106(a)).

Mary may not treat the \$3,500 premium or any part of it as a medical expense. As a result, she has only \$2,400 in medical expenses for 2008. Since these expenses do not exceed 7.5% of her AGI ( $\$50,000 \times 7.5\% = \$3,750$ ), she may not deduct them from income (IRC §213(a)).

### EMPLOYER PAYING PREMIUMS FOR EMPLOYEE



*This chart applies to all employer/employee relationships, and to S Corporations and their 2% or less stockholders.*

## PARTNERSHIP

Partnership employer pays premium for (a) non-partner employees, and (b) partners who perform services, and in both cases such coverage is provided in connection with the performance of such services.

*Assumption:* ABC is a partnership. It pays the \$3,500 annual premium for a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy Mary owns. Mary is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000, not counting the \$3,500 LTCI premiums ABC pays.

### Tax Treatment of Employer

Generally, a partnership may deduct all premiums it pays for accident and health insurance coverage (including premiums paid for tax qualified LTCI) for its employees, their spouses and eligible dependents (IRC §§ 152 and 162).

If Mary is an employee (and not a partner), the partnership may pay and deduct the entire LTCI premiums for policies owned by Mary, her spouse, and eligible dependents (IRC §152) – even premiums in excess of the age-based limits on page 2 (IRC §162).

If Mary is a partner (or the spouse or eligible dependent of a partner (IRC §152)), ABC may pay the entire LTCI premiums for Mary, her spouse, and eligible dependents – even premiums in excess of the age-based limits on page 2 (IRC §162).

As long as the LTCI premiums are paid without regard to partnership income they will be considered “guaranteed”<sup>◇</sup> payments under IRC §707(c). As such, they will be deductible to the partnership under IRC §162 (subject to IRC §263), and includable in the partners’ incomes under IRC §61 (Rev. Rul. 91-26, 1991-1, C.B. 184).

In our example, the premiums are paid without regard to partnership income (they are “guaranteed”<sup>◇</sup>). As a result, ABC may deduct the full \$3,500 premium it pays for Mary’s LTCI policy regardless of whether Mary is an employee or a partner. If Mary is a partner,

ABC reports the premium it pays for Mary’s policy (and for policies owned by Mary’s spouse and eligible dependents) as income to Mary.

### Tax Treatment of Policyowner (partner/employee)

The IRS treats partners as self-employed persons. As a result, LTCI premiums the partnership pays for each partner (including premiums paid for policies owned by a partner’s spouse and eligible dependents (IRC §152)) are included in the partner’s individual income, and reported on each partner’s IRS form K-1.

See the discussion on page 6 about the deduction for self-employed persons that Mary, as a partner, may take for ABC’s payment of her LTCI premiums.

A self-employed person may not deduct LTCI premiums for any month that she or her spouse is eligible to participate in an employer subsidized health plan. See the discussion on page 6. In this example, Mary is self-employed for the entire year.

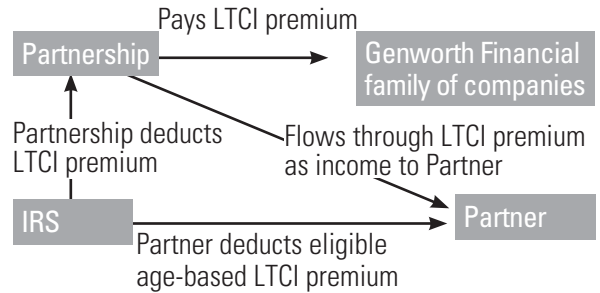
<sup>◇</sup> The term, “guaranteed” in this context carries a restricted meaning under the IRC. It means that the payment of the LTCI premium to the partners does not come from the partners’ draws (or from the net income left at the end of the year used to make those draws). The partners are “guaranteed” their LTCI premiums only in the limited sense that the partnership treats the LTCI premium payments to them as expenses that must be paid regardless of whether the partnership makes money in a given year or not.

## PARTNERSHIP (CONT.)

If Mary is a partner (and therefore taxed as a self-employed person), her income rises by the \$3,500 ABC pays for her LTCI premiums. This increase in income is partly offset by the \$3,080 she may deduct (her age-based limit), for a net increase in income of \$420.

If Mary is an employee, she need not include in income the premiums ABC pays for her LTCI policy, or the premiums ABC pays for a LTCI policy owned by her spouse or eligible dependents (IRC §152).

### PARTNERSHIP PAYS PREMIUMS FOR PARTNER



*Same tax treatment for LLCs and their members, and for S Corporations and their greater than 2% stockholders.*

## LIMITED LIABILITY COMPANY (LLC)

**LLC pays premium for employees and LLC member-owner of the entity.**

*Assumption:* ABC is an LLC. It pays the \$3,500 annual premium for a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy Mary owns. Mary is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000, not counting the \$3,500 LTCI premiums ABC pays.

### Tax Treatment of Employer

If the limited liability company (LLC) has elected partnership tax treatment, it is treated as a partnership for purposes of these rules. Owners of LLCs are called members. See the rules regarding partnerships on page 9.

If Mary is an employee (and not a member) the LLC may pay and deduct the entire LTCI premiums for policies owned by Mary, her spouse, and eligible dependents (IRC §152) — even premiums in excess of the age-based limits discussed on page 2 (IRC §162).

If Mary is a member (or the spouse or eligible dependent of a member (IRC §152), ABC may deduct the entire LTCI premiums paid for Mary, her spouse, and eligible dependents — even premiums in excess of the age-based limits on page 2 (IRC §162)).

For LLCs that have elected partnership tax treatment, as long as the LTCI premiums are paid without regard to LLC income they will be considered “guaranteed”<sup>◇</sup> payments under IRC §707(c). As such, they will be deductible to the LLC under IRC §162 (subject to IRC §263), and includable in the members’ incomes under IRC §61 (Rev. Rul. 91-26, 1991-1, C.B. 184).

<sup>◇</sup> See page nine for an explanation of the term, “guaranteed” in this context

## LIMITED LIABILITY COMPANY (CONT.)

In our example, the premiums are paid without regard to LLC income (they are “guaranteed”<sup>◇</sup>). As a result, ABC may deduct the entire \$3,500 premium it pays for Mary’s LTCI policy regardless of whether Mary is an employee or a member. If Mary is a member, ABC reports the premium it pays for Mary’s policy (and for policies owned by Mary’s spouse and eligible dependents) as income to Mary.

### Tax Treatment of Policyowner (owner/employee)

If the LLC has elected partnership tax treatment, the IRS treats LLC members as self-employed persons. As a result, LTCI premiums the LLC pays for each member (including premiums paid for a member’s spouse and eligible dependents) are included in the member’s individual income, and reported on each member’s IRS form K-1.

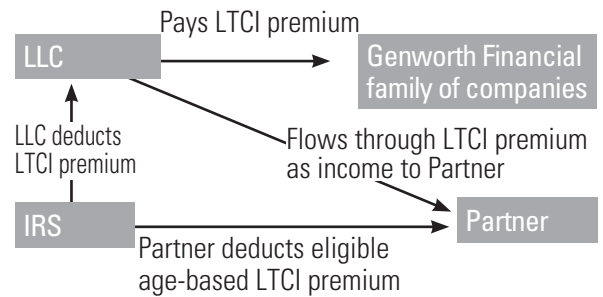
See the discussion on page 6 for self-employed persons about the deductibility of income attributed to Mary as an LLC member from ABC’s payment of her LTCI premiums.

A self-employed person may not deduct LTCI premiums for any month when she or her spouse is eligible to participate in an employer subsidized health plan. See the discussion on page 6. In this example, Mary is self-employed for the entire year.

If Mary is a member (and therefore taxed as a self-employed person), her income rises by the \$3,500 ABC pays for her LTCI premiums. This increase in income is partly offset by the \$3,080 she may deduct (her age-based limit), for a net increase in income of \$420.

If Mary is an employee, she need not include in income the premiums ABC pays for her LTCI policy, or the premiums ABC pays for a LTCI policy owned by her spouse or eligible dependents.

### LLC PAYS PREMIUMS FOR PARTNER



*Same tax treatment for Partnerships and for S Corporations and their greater than 2% stockholders.*



<sup>◇</sup> See page nine for an explanation of the term, “guaranteed” in this context.

## S CORPORATIONS

**S corporation pays premium for employees and shareholders.**

*Assumption:* ABC Corp is an S Corporation. It pays the \$3,500 annual premium for a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy Mary owns. Mary is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000, not counting the \$3,500 LTCI premiums ABC pays.



### Tax Treatment of Employer

An S Corporation is treated as a partnership for purposes of these rules (see the rules regarding partnerships on page 9). The S Corporation may deduct LTCI premiums paid both on behalf of its owners (shareholders who individually own more than 2% of the stock) and its employees (including shareholders who individually own 2% or less of the stock). The deductions are not limited to the age-based limits on page 2).

In our example, ABC may deduct the full \$3,500 premium it pays for Mary's LTCI policy regardless of whether Mary is an employee, a 2% or less shareholder, or a greater than 2% shareholder.

### Tax Treatment of Policyowner (owner/employee)

The IRS treats greater than 2% S Corporation shareholders as self-employed persons (IRC §1372). Further, LTCI premiums paid to greater than 2% S corporation shareholders are treated like "guaranteed"<sup>◇</sup> payments to partners (Rev. Rul. 91-26, 1991-1, C.B. 184). See page 9. As a result, LTCI premiums the S Corporation pays for each greater than 2% shareholder (including premiums paid for the shareholder's spouse and eligible dependents) are included in the shareholder's income under IRC §61, and reported on their IRS form K-1.

However, while Rev. Rul. 91-26 requires the greater than 2% S corporation shareholder to include in income amounts paid by an S corporation for accident and health insurance covering them, such payments are not wages for FICA (Social Security and Medicare) tax purposes (Announcement 92-16, 1992-5 I.R.B. 53).

See the discussion on page 6 regarding Mary's deduction for LTCI premiums.

<sup>◇</sup> See page nine for an explanation of the term, "guaranteed" in this context.

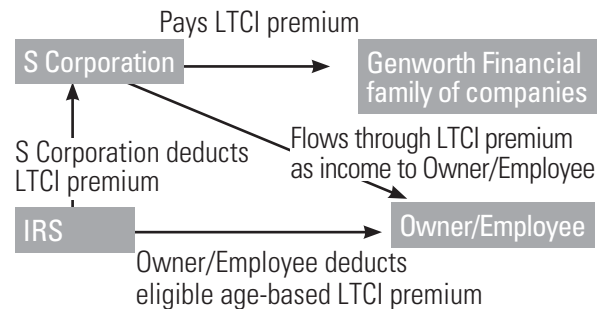
A self-employed person may not deduct LTCI premiums for any month when she or her spouse is eligible to participate in an employer subsidized health plan. See the discussion on page 6. In this example, Mary is self-employed for the entire year. If Mary is a greater than 2% shareholder (and therefore taxed as a self-employed person), her income increases by the \$3,500 ABC pays for her LTCI premiums. This increase in income is partly offset by the \$3,080 she may deduct, for a net increase in income of \$420.

If Mary is an employee or a 2% or less shareholder, she need not include in income the premiums ABC pays for her LTCI policy, or the premiums ABC pays for a LTCI policy owned by her spouse or eligible dependents.

One strategy that many self-employed persons use to deduct premiums paid for an employee/spouse's qualified LTCI policy—employ their spouse in the business—will not work with an S Corporation. The attribution rules under IRC §318 cause ownership of an individual's S Corporation stock to be attributed to their spouse, children, grandchildren, and parents.

As a result, the spouse and family members employed by the S Corporation will be treated as if they were self-employed, not as if they were employees, even if in fact they do not personally own any S Corporation stock. They will have to include the LTCI premiums the S Corporation pays for them in income, and will be able to deduct the lesser of those premiums and the age-based premiums as if they were self-employed.

### **S CORPORATION PAYS PREMIUMS FOR OWNER/EMPLOYEE**



*Same tax treatment for LLCs and their members, and for Partnerships.*

## CONTRIBUTORY ARRANGEMENTS

Employer pays part of the premium, employee pays the rest.

*Assumption:* ABC is an employer. It pays \$1,000 towards the \$3,500 annual premium for a tax qualified Genworth Life Insurance Company Long Term Care Insurance policy Mary owns. Mary is 61 years old. In 2008, she had \$2,400 in medical expenses not covered by insurance. Her adjusted gross income (AGI) is \$50,000, not counting the \$1,000 LTCI premiums ABC pays.

### Tax Treatment of Employer

The employer receives the same federal income tax treatment on the portion of LTCI premium it pays that it does on the entire premium in the employer-pay-all situation (IRC §162). Thus, all employers (self-employed persons, C Corporations, partnerships, LLCs and S Corporations) may deduct tax qualified LTCI premiums paid for policies owned by their *employees* (and in the case of an S Corporation, its 2% or less shareholders), and their employees' spouses and eligible dependents (IRC §152) without regard to the age-based limits (page 2).

In addition, partnerships, LLCs and S Corporations may deduct LTCI premiums paid for policies owned, respectively, by those entities' partners, members, and greater than 2% shareholders, and their spouses and eligible dependents. The entity then reports the premium as income to the owner.

In our example, ABC may deduct the \$1,000 it pays towards Mary's LTCI premium (and any part of LTCI premium it pays for

Mary's spouse and eligible dependents) regardless of whether Mary is an employee or an owner. Except in the case of a C Corporation, if Mary is an owner, ABC reports the premium it pays for her policy (and for policies owned by her spouse and eligible dependents) as income to Mary.

### Tax Treatment of Policyowner (owner/employee)

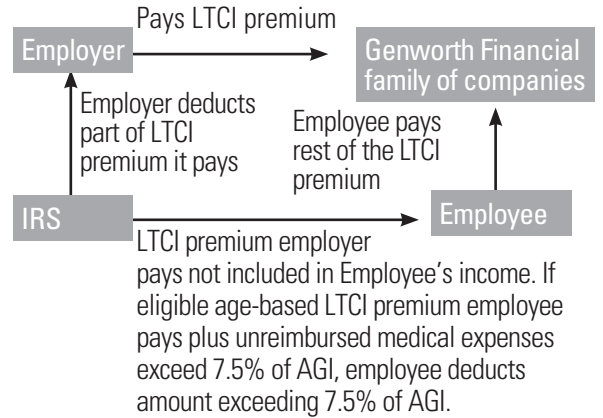
Except in the case of a C corporation, if Mary is an owner (including a greater than 2% S Corporation shareholder), she is treated as a self-employed person under these rules. Her income rises by the \$1,000 ABC pays for her LTCI premiums. She pays the remaining \$2,500 premium herself. She may deduct \$3,080, that amount representing the lesser of the age-based limit—\$3,080—and the sum of (1) the premium added to her income and (2) the premium she pays herself (\$1,000 plus \$2,500). The remaining \$420 is not considered a medical expense and is not deductible. See the age-based limits (page 2), and the discussion for self-employed persons (page 6).



If Mary is an employee (including a 2% or less shareholder of an S Corporation), she does not have to include in taxable income the \$1,000 ABC pays (nor any money it pays for policies owned by her spouse and eligible dependents). The remaining \$2,500 in LTCI premiums that Mary pays is less than the age-based limit of \$3,080 (page 2). For deductibility purposes, therefore, she may add the entire \$2,500 LTCI premium expense she pays to her \$2,400 in medical expenses not covered by insurance for a total of \$4,900 in medical expenses.

7.5% of Mary's \$50,000 AGI is \$3,750. She may deduct from income that part of her qualified medical expenses that exceeds 7.5% of AGI, or \$1,150 ( $\$4,900 - \$3,750 = \$1,150$ ), assuming that she itemizes deductions.

### EMPLOYER PAYING PREMIUMS FOR CONTRIBUTORY ARRANGEMENTS



*This chart applies to all employer/employee relationships, and to S Corporations and their 2% or less stockholders.*

## HEALTH SAVINGS ACCOUNTS AND LONG TERM CARE INSURANCE

The Medicare Act of 2003 allows individuals to create Health Savings Accounts (HSAs). Contributions to an HSA are made on a pre-tax basis, while withdrawals for qualified medical expenses are made tax-free. Any growth inside an HSA is tax-free if withdrawals are made for qualified medical expenses, or tax-deferred if withdrawals are made for other purposes.

Qualified LTCL premiums are a qualified medical expense. (IRS Notice 2004-50, Q and A 41). As a result, an individual may withdraw money tax-free from their HSA to pay qualified LTCL premiums. Qualified LTCL premiums are the lesser of the actual premiums paid and the eligible "aged-based" premiums (page 2). Therefore, only the qualified LTCL premiums may be withdrawn tax free from an HSA.

### Some of the criteria for owning an HSA are:

The individual must be covered by a high deductible health plan (IRC §223(c)(1)(A)(ii)).

- Annual deductible of \$1,100 for individuals, \$2,200 for a family (2008 limits, adjusted for inflation)
- Annual out-of-pocket limits not exceeding \$5,600 for an individual, \$11,200 for a family (2008 limits, adjusted for inflation)

The individual may not be covered under a non-high deductible health plan (HDHP) or a plan that duplicates benefits of their own plan (IRC §223(c)(1)(A)(ii)), such as a spouse's plan through the spouse's employer.

However, an individual may be covered under some types of insurance that do not require high deductibles (such as a qualified LTCL policy) and still own an HSA (IRC §223(c)(1)(B)(ii)).



*Assumption:* Mary is single, and employed by ABC. She is 61 years old. Her adjusted gross income (AGI) is \$50,000. She is a member of ABC's high deductible health care plan. Under the plan, Mary must pay a deductible of up to \$1,100 for each medical service she receives, subject to a maximum cumulative deductible of \$5,600 per year.

### **Deductibility for Contributions to an HSA is denied when:**

- The individual is claimed as a dependent on another's income tax return (IRC §223(b)(6)), or
- The individual becomes covered by Medicare (IRC §223(b)(7)).

### **Contribution Limits**

The maximum monthly contribution amount is 1/12 of the statutory annual maximum (\$2,900 for individuals and \$5,800 for families (IRC §223(a)(2), 2008 limits, amounts indexed to inflation)). These limits are decreased by aggregate contributions made to an Archer MSA (IRC §223(a)(4)).

Individuals who first become eligible on or before December 1 of a tax year are treated as though they had been eligible for that entire year. The individual, though, must continue to be eligible for a 12 month period beginning December of the enrollment year, otherwise, contributions attributed to months prior to the month of enrollment will be included in taxable income and subject to a 10% penalty tax.

Individuals between 55 and 65 may also make additional catch-up contributions. For 2008, the additional allowed catch-up contribution is \$900. This amount is scheduled to rise to \$1,000 in 2009.

Mary owns an HSA. In 2008, she may contribute a maximum of \$2,900 to her HSA, plus a catch-up contribution of \$900, for a total of \$3,800. Her HSA contributions are tax-deductible, and any growth is tax-free as long as distributions are taken for qualified medical expenses.

Any other type of distribution is included in taxable income and subject to a 10% penalty tax. Unlike Flexible Spending Accounts, HSA account balances do not have to be entirely withdrawn by the end of the year or forfeited. Assuming Mary achieves a 3% rate of return on her monthly HSA contributions, she will have an account balance of \$3,914 by year-end.

Mary also owns a Genworth Life Insurance Company Long Term Care Insurance policy. Her annual premiums are \$3,500. Her eligible age-based premiums are \$3,080. ABC does not pay any part of her LTCI premiums. However, Mary's eligible premiums are a qualified medical expense for HSA purposes. As a result, Mary may withdraw up to \$3,080 tax-free from her HSA to help pay her LTCI premiums. The balance of her LTCI premium, \$420, is not a qualified medical expense, and Mary may not withdraw HSA funds to pay for it.

In 2008, Mary also had \$2,400 in medical expenses not covered by insurance, in addition to her LTCI premiums. Assuming that these expenses are qualified medical expenses under the HSA rules, Mary may withdraw the remaining \$834 from her HSA to help pay them. Her remaining unreimbursed medical expenses, \$1,566, do not exceed 7.5% of her AGI (even allowing for deductions for HSA contributions), and are not deductible.

## CHANGES TO “GRANDFATHERED/ TAX QUALIFIED” LONG TERM CARE INSURANCE POLICIES

Final IRS Regulations are in effect for “grandfathered” LTCI policies, those issued before January 1, 1997. Here are the changes to grandfathered Genworth Life Insurance Company LTCI policies that will be considered disqualifying, and those which will not (Treas. Regs. § 1.7702B-2).



### **Changes not considered disqualifying (will NOT affect tax qualified status)**

- Reductions in Coverage (at lower premiums)
  - Decrease in Daily Benefit Amount
  - Increase in the Length of the Elimination Period
  - Decrease to Benefit Period or Policy Maximum Benefit Amount
  - Deletion of Inflation or Benefit Increase Rider
- Changes in Premium Mode
- Adding a Couples Discount

### **Changes considered disqualifying (WILL affect tax qualified status)**

- Increase in Daily Benefit Amount
- Decrease in the Length of the Elimination Period
- Increase in Benefit Period/Policy Maximum Benefit Amount
- Addition of Currently Available Inflation or Benefit Increase Riders

## APPENDIX: STATE LONG TERM CARE INSURANCE TAX CREDITS AND DEDUCTIONS

State	Deduction or Credit	State	Deduction or Credit
Alabama	Deduction	Mississippi	Credit
Arkansas	Deduction	Missouri	Deduction
California	Deduction	Montana	Deduction
Colorado	Credit	Montana	Credit**
District of Columbia	Deduction	Nebraska	Deduction
Hawaii	Deduction	New Jersey	Deduction
Idaho	Deduction	New Mexico	Deduction
Indiana	Deduction	New York	Credit
Iowa	Deduction	North Dakota	Credit
Kansas	Deduction	Ohio	Deduction
Kentucky	Exclusion	Oklahoma	Deduction
Maine	Deduction	Oregon	Credit
Maine	Credit*	Utah	Deduction
Maryland	Credit	Virginia	Deduction or Credit
Maryland	Credit*	West Virginia	Deduction
Minnesota	Credit	Wisconsin	Deduction

*Note: Not all states offer a full deduction or credit.*

*\* For employers providing LTCI in benefits package*

*\*\* For LTCI premiums paid for a qualifying family member over age 65*

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Genworth Life Insurance Company of New York, Administrative Offices: Richmond, Virginia

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