



2011 Federal and State Tax Guide

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Introduction

This brochure presents an overview of the rules and regulations concerning the tax implications of 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 Tax Department. Clients should consult with their legal tax advisor regarding tax issues.

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Individual Purchase

Tax-qualified LTCI premiums are considered medical expenses. 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 LTCI premiums, as defined by Internal Revenue Code¹ section 213(d)(10), based on the age of the insured individual. The 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

	2011
Ages 40 or Less	\$340
Ages 41 to 50	\$640
Ages 51 to 60	\$1,270
Ages 61 to 70	\$3,390
Ages Over 70	\$4,240

The 2011 per diem limitation under IRC 7702B(d)(4), regarding periodic payments received under a qualified LTCI contract, is \$300.

EXAMPLE

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
Eligible LTCI Premium (Table 1)	\$1,270
Total Medical Expenses	\$5,270 (\$4,000 Medical Expenses + \$1,270 of Eligible LTCI Premiums)
7.5% of AGI	\$4,125
Medical Expenses that Exceed 7.5% of AGI	\$1,145 (\$5,270 – \$4,125)
Total Itemized Deduction Permitted	\$1,145

1. Internal Revenue Code will hereinafter be referred to 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, are excluded from Adjusted Gross Income. [IRC 7702B and 104 (a)(3)]

Self-Employed

A self-employed individual can deduct 100% of his/her out-of-pocket LTCI 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 LTCI plan. A subsidized LTCI plan is one for which an employer pays part or all of the premiums for LTCI. Under our interpretation of IRC 162(l)(2)(B), for any month in which a self-employed individual is eligible to participate in an 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

Age of Self-Employed Individual	55
Gross Income	\$60,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Eligible LTCI Premium (Table 1)	\$1,270
Gross Income Less Deduction	\$58,730 (\$60,000 – \$1,270)

Generally, benefits received from a tax-qualified LTCI policy that was purchased by an

Partnership Limited Liability Company (LLC) Subchapter S Corporation

Partners of 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 must include the LTCI premium paid on his/her benefit in his/her Adjusted Gross Income, but may deduct up to 100% of the age-based Eligible Premium amount, as listed in Table 1.³ It is not necessary to meet a 7.5% AGI threshold in order to take this deduction.

EXAMPLE

Age of Partner	55
Gross Income	\$60,000
Annual Premium for Tax-Qualified LTCI Policy	\$2,000
Eligible LTCI Premium (Table 1)	\$1,270
Gross Income Less Deduction	\$60,730 (\$60,000 + \$2,000 – \$1,270)

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

² IRC 1372 provides that a more than individual are

Subchapter C Corporation

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When a business purchases a John Hancock tax-qualified LTCI policy on behalf of any of its employees, and their spouses or dependents, the corporation is entitled to take a 100% deduction as a business expense on the total premiums paid.⁴ 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 IRC nondiscrimination rules. Therefore, an employer can be selective in the classification of employees it elects to cover (e.g., a select group of officers).

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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 1.⁶ This exclusion applies to shareholders/employees (as long as they are treated as employees) in a Subchapter C Corporation and to shareholders/employees who own 2% or less of a Subchapter S Corporation.

EXAMPLE

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

Generally, benefits received under an employer-purchased tax-qualified LTCI policy are non-taxable, and therefore, are excluded from the employee's Adjusted Gross Income [IRC 7702B, 104(a)(3) and 105].

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].

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 expense.⁷ The deductions are not limited by the age-based limits on Eligible Premium listed in Table 1. 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 include the balance that he/she pays with his/her medical expenses, up to the Eligible Premium amount, and accordingly would be entitled to an itemized deduction for medical expenses that exceed 7.5% of AGI.

EXAMPLE: Employee Deduction

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
Eligible LTCI Premium (Table 1)	\$1,270
Total Medical Expenses	\$7,270 (\$6,000 medical expenses + \$1,270 of eligible LTCI premiums)
7.5% of AGI	\$4,125
Medical Expenses that Exceed 7.5% of AGI	\$3,145 (\$7,270 – \$4,125)
Total Itemized Deduction Permitted	\$3,145

7.[IRC 162(a)].

EXAMPLE: Employer Deduction

Premium Paid by Employer	\$500
Total Deduction as a Business Expense	\$500

Generally, benefits received under an employer-purchased tax-qualified LTCI policy are non-taxable, and therefore, are excluded from the employee's Adjusted Gross Income.

Gift Tax Exclusion

In addition to the annual Gift Tax Exclusion of \$13,000 (for 2011) per donee, a donor has the ability to pay for the medical expenses of the donee.⁸ 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, to the extent that the premiums don't exceed the eligible LTCI premiums, can still maintain the annual Gift Tax Exclusion. If the donor pays more than the donee's eligible premium the excess amount will reduce the donor's annual \$13,000 Gift Tax Exclusion.

EXAMPLE: Employee Deduction

Annual Gift Tax Exclusion	\$13,000
Age of LTCI Policy Recipient (Donee)	55
Annual Premium for Tax-Qualified LTCI Policy (Paid by Donor)	\$1,500
Eligible LTCI Premium (Table 1)	\$1,270
Premium Amount that Would Reduce the Annual Gift Tax Exclusion	\$230 (\$1,500 – \$1,270)
Amount of Taxpayer's Remaining Annual Gift Tax Exclusion for Donee	\$12,770 (\$13,000 – \$230)

8.[IRC 2503(e)].

Other considerations

1035 exchanges (Section 1035)

Includes provisions to encourage individuals to purchase LTCI, by making it more tax favorable under certain circumstances, including 1035 exchanges. A 1035 exchange (Internal Revenue Code § 1035) permits owners of life insurance and non-qualified annuities to exchange all or a portion of their contracts for certain types of contracts, without being taxed on the unrealized gain at the time of transfer. Starting in 2010, tax-free 1035 exchanges of life insurance, endowment, and non-qualified annuity contracts for LTCI policies are allowed.

Refund

Upon surrender or cancellation of the LTCI contract during the insured's lifetime, any refund shall be includible in gross income to the extent that any deduction or exclusion was allowable with respect to the premiums.

Upon death of the insured, any refund may be included in the beneficiary's gross income to the extent that it was either excluded from the owner's income or deducted by the owner.

The client should consult his/her tax advisor for the tax consequences of any return of premium.

Reimbursement through an HSA (Section 223)

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.

Reimbursement through an HRA (Section 105)

Reimbursements for insurance covering medical care expenses, as defined in IRC Sec. 213(d), which includes qualified long-term care services and qualified LTCI 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 LTCI premiums cannot be paid on a pre-tax basis through an HRA.

Employer-provided 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.

Reimbursement through an FSA (Section 223)

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

9. As of the printing of this guide, John Hancock is awaiting further clarification from the IRS on the technical treatment of 1035 exchanges for LTCI, in order to ensure proper implementation on behalf of our policyholders.

State Tax Incentives

The information provided in this chart is general and informational only. The information is not tax advice and does not guarantee that state benefits will be available. One should consult his/her tax advisor to determine if state tax benefits are available in his/her situation. This chart represents state law as it existed when this chart was created and may not reflect recent changes in state law.

Alabama	Deduction	A deduction is allowed for the amount of premiums paid pursuant to a qualifying insurance contract for qualified LTCI coverage.
Alaska	None	None
Arizona	None	None
Arkansas	Deduction	"Eligible" LTCI premiums may be deductible as medical expenses when such premiums are paid towards "qualified" LTCI. The definition of "qualified" LTCI is set forth in IRC Sec. 7702B(b)(1). This deduction for unreimbursed medical expenses can be taken only to the extent such expenses exceed 7.5% of the taxpayer's AGI. (e.g. same deduction allowed federally.)
California	Deduction	Permits the same tax deduction as is allowed for federal income tax purposes for premiums paid for the purchase of qualified LTCI.
Colorado	Credit	State income tax credit equal to the lesser of 25% of premiums paid for an LTCI policy or \$150 per policy. Individuals who qualify for the credit are those with federal taxable income less than \$50,000 (\$100,000 for joint filers claiming a credit for 2 policies). An LTCI policy must meet Colorado's definition of long-term care.
Connecticut	None	None
Delaware	None	None
District of Columbia	Deduction	A deduction in the amount an individual pays annually in premiums paid for LTCI is permitted from gross income, provided that the deduction not exceed \$500 per year, per individual, whether the individual files individually or jointly. An LTCI policy must meet the District of Columbia's definition of long-term care.
Florida	None	None
Georgia	None	None
Hawaii	Deduction	An individual state tax deduction is allowed for LTCI premiums. This deduction is limited in the same manner as the deduction on the federal level, and is also only available to the extent that all medical expenses, including long-term care, exceed 7.5% of Hawaii Adjusted Gross Income instead of the Federal Adjusted Gross Income.

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Idaho	Deduction	Premiums paid during the taxable year, by a taxpayer for LTCI, which LTCI is to be for the benefit of the taxpayer, a dependent of the taxpayer or an employee of the taxpayer, may be deducted from taxable income to the extent that the premium is not otherwise deducted or accounted for by the taxpayer for Idaho income tax purposes. The deduction may be taken for a federally tax-qualified LTCI policy meeting Idaho's definition of LTCI.
Illinois	None	None
Indiana	Deduction This deduction applies only to IN Partnership Policies.	An individual taxpayer is permitted to deduct an amount equal to the eligible portion of premiums paid during the taxable year by the taxpayer for a qualified LTCI policy (as defined in the Indiana Code) for the taxpayer, the taxpayer's spouse, or both. Deduction only applies to the Partnership program. Ind. Code § 6-3-1-3.5 and § 12-15-39.6.5 (Qualified Long-Term Care Policy).
Iowa	Deduction	Permits tax deduction from net income for premiums paid for LTCI coverage for nursing home coverage to the same extent allowable under federal law and to the extent not otherwise deducted in computing Adjusted Gross Income.
Kansas	Deduction	A deduction is allowed up to \$1,000 of the premium cost for a qualified long-term care insurance contract.
Kentucky	Exclusion	A taxpayer may exclude from Kentucky Adjusted Gross Income any amounts paid for LTCI as defined in the Kentucky Code.
Louisiana	Credit	A credit against the individual income tax for amounts paid as premiums for eligible LTCI. The amount of the credit shall be equal to 10% of the total amount of premiums paid annually by each individual claiming the credit and must meet the specified qualification requirements.
Maine	Credit/ Deduction	CREDIT: An employer providing long-term care benefits to its employees may qualify for the tax credit. A credit is allowed against the tax imposed for each taxable year equal to the lowest of the following: (A) \$5,000; (B) 20% of the costs incurred by the taxpayer in providing LTCI policy coverage as part of the benefit package; or (C) \$100 for each employee covered by an employer-provided LTCI policy. DEDUCTION: A taxpayer is entitled to a state tax deduction for qualified LTCI premiums as long as the amount deducted is reduced by any amount deducted for federal income tax purposes and by any LTCI premiums claimed as an itemized deduction pursuant to Maine Rev. Stat. tit. 36 section 5125. The long-term care contract must be certified under Maine Revised Statutes Ann. Title 24-A., Section 5075-A
Maryland	Credit	A credit is allowed against the state income tax for employers providing long-term care insurance up to an amount equal to 5% of the costs incurred by the employer during the taxable year for providing long-term care insurance as apart of an employee benefit package. The credit may not exceed \$5,000 or \$100 for each employee covered. A one-time credit is allowed an individual against the state income tax in an amount equal to 100% of the eligible federally qualified long-term care insurance premiums covering the individual, spouse, parent, step-parent, child, or step-child, not to exceed \$500.

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Massachusetts	None	None
Michigan	None	None
Minnesota	Credit	A taxpayer is allowed a tax credit for premiums paid during the tax year for LTCI \$(as defined under Minnesota law). The credit for each policy is equal to

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Nevada	None	None
New Hampshire	None	None
New Jersey	Deduction	Allows a deduction for medical expenses (including LTCI premiums for taxpayers, their spouses or dependents) to the extent such expenses exceed 2% of taxpayer's gross income.
New Mexico	Credit/ Exemption	CREDIT: Allows taxpayers 65 and older and not a dependent of another taxpayer to claim a credit of \$2,800 for medical care expenses, which includes LTCI 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. EXEMPTION: Taxpayers 65 and older are entitled to an exemption of \$3,000 for medical care expenses, which include long-term care insurance premiums, if such expenses equal \$28,000 or more within a taxable year and are unreimbursed or uncompensated..
New York	Credit	A credit for personal income tax is allowed equal to 20% of the premium paid during the taxable year for qualified long-term care insurance. A credit is allowed against the corporation tax equal to 20% of the premiums paid during the taxable year for qualified long-term care insurance. The credit may not reduce the tax payable to less than the state minimum tax, but any excess credit may be carried forward. An S corporation is allowed a credit against the personal income tax equal to 20% of the premium paid during the taxable year for qualified long-term care insurance.
North Carolina	Credit	This tax credit allows a credit of 15% of the premiums paid for LTCI during the taxable year and is limited to taxpayers with less than specific adjusted gross incomes based on filing status (e.g., earning less than \$100,000 for a married couple). Up to \$350 is allowed for each LTCI contract.
North Dakota	Credit	Allows for a tax credit equal to premiums paid but not to exceed \$250 in each taxable year for state residents who paid premiums on a North Dakota LTC Partnership qualified plan covering the taxpayer or his/her spouse. The credit is effective for tax years beginning in 2009.
Ohio	Deduction	Allows a deduction for the amount paid for qualified LTCI for the taxpayer, his/her spouse, and dependents (but only to the extent not otherwise allowable as a deduction or exclusion in computing federal or Ohio adjusted gross income).
Oklahoma	Deduction	Permits the same tax deduction as is allowed for federal income tax purposes.
Oregon	Credit	A credit is allowed for amounts paid or incurred for LTCI by an individual on behalf of individual, dependents or parents and for amounts paid or incurred by an employer on behalf of employees. The credit is limited to the lesser of 15% of premiums or \$500. In order for the credit to be available the policy must be issued after January 1, 2000. The credit is not refundable and cannot be carried forward.

