

# Taxation Guide



In 1996, the Health Insurance Portability and Accountability Act (HIPAA) outlined requirements for qualified long-term care (LTC) policies under the Internal Revenue Code (IRC) section 7702B.

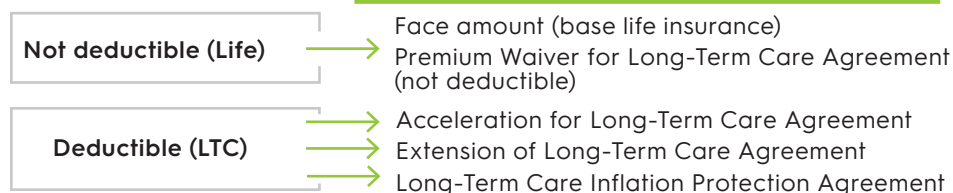
This act also defined a linked-benefit contract with qualified LTC features as a 7702B policy. Some of the benefits and payments for these policies are afforded the same tax treatment as individual LTC policies.<sup>1</sup>

Qualified LTC premiums are considered a medical expense under IRC sections 7702B and 213. The premium associated with the face amount, or the base life insurance policy, and the premium waiver agreement, if elected, generally do not qualify as medical expenses. However, premiums associated with the Acceleration for Long-Term Care Agreement, the Extension of Long-Term Care Agreement, and the Long-Term Care Inflation Protection Agreement generally are considered payments towards a qualified LTC contract.<sup>1</sup> The premiums associated with these benefits are calculated and noted both within a proposal and the data pages of a policy.

In order to be a qualified long-term care contract, there can be no cash value. The three LTC agreements that are part of the SecureCare III policy do not have cash value and the premiums for the LTC portion of the contract are paid directly to Securian Financial for the LTC benefit. Since Securian Financial charges a premium and that premium is never part of the cash value of the life insurance policy, our clients have a reasonable argument that they should be able to deduct those premiums, subject to the age-based limitations.

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## Linked-Benefit annual premium



1. IRC section 7702B(e)(1) and IRC Section 7702B(e)(2). Payments made for the policy are not eligible for the advantageous tax treatment if they are a "charge against the cash surrender value of a life insurance contract." SecureCare III incorporates a separate long-term care premium payment, rather than a charge.

# Tax treatment of SecureCare III to individuals

## When are premiums for SecureCare III tax deductible?

### Itemized deduction for medical expenses

If an individual has medical expenses that exceed 7.5% of their adjusted gross income (AGI), they may deduct all, or a portion of the premium payments for the tax-qualified agreements as itemized medical care expenses on their federal tax return.<sup>2</sup> However, only the amount of total medical expenses that exceed 7.5% of AGI are eligible. Premiums paid for a qualified LTC contract may be used in the calculation to satisfy the 7.5% threshold.

The deduction and limit on the deduction applies to each taxpayer and they may take this deduction for their spouse and dependents.<sup>3</sup> Deductions may be taken annually, for as long as the individual is paying premiums and they meet the deductibility requirements.

### If the client has itemized medical expenses that exceed 7.5% of AGI, there are three steps to determine when the premiums are tax deductible.

#### Step 1: Determine the amount of premium paid for:

- Acceleration for Long-Term Care Agreement
- Extension of Long-Term Care Benefits Agreement
- Long-Term Care Inflation Protection Agreement

#### Step 2: Review Age-Based Limitations

Attained-age before the close of the taxable year	2023 limit	2024 limit
40 or less	\$480	\$470
41-50	\$890	\$880
51-60	\$1,790	\$1,760
61-70	\$4,770	\$4,710
71+	\$5,960	\$5,880

Source: IRC Section 213(d)(1)(D)

#### Step 3: Potential itemized deductions

If itemized medical expenses exceed 7.5% of AGI, compare the totals from Step 1 and Step 2. Taxpayers may deduct whichever is less: the premium or the limit for the relevant year as indicated on the chart above.

2. Internal Revenue Code (IRC) Section 213(a).

3. As defined by IRC Section 152 without regard to subsections (b)(1), (b)(2), and (d)(1)(B) of IRC Section 152.

4. The death proceeds, return of premium amount and long-term care benefit amount depend, in part, on the return of premium option selected on the policy application. This option cannot be changed after the policy is issued.

### Return of Premium<sup>4</sup>

Upon surrender or cancellation of a SecureCare III policy, refunded premium that was previously deducted, or excluded, may be included in gross income and may be considered taxable.



**Please note: a client should always consult with his or her tax attorney or accountant on the deductibility of the premiums.**

# What are the tax-free limits for benefit payments?

## LTC Benefit

There are two ways qualified LTC benefit payments may avoid being taxed as income:

1. Any LTC benefit amount paid that does not exceed the per diem limit is excluded from income.
2. Any LTC benefit amount that exceeds the per diem limit may be excluded from income if the individual shows documented qualified LTC expenses. Otherwise, the benefits that exceed the per diem limit are included in income. This rule also takes into consideration any payments made to a terminally ill individual.

SecureCare III benefits paid are generally not included in the taxpayer's gross income.<sup>5</sup>

## Death Benefit

Are the death proceeds paid to beneficiaries income tax free?

Yes, the taxability of the death proceeds of a life insurance contract are generally exempt from income taxation.<sup>6</sup>

## Trust-Owned SecureCare III policies

A SecureCare III policy may be owned by either a revocable or irrevocable trust. It is important to note, the taxation of benefits paid to the Trust for qualified LTC expenses follows the Individual Tax Guidelines as previously noted. This includes the IRS Per Diem limits.

Typically, with a revocable trust, the grantor of the trust will be both the trustee and the insured and therefore, an insurable interest generally exists.

With an irrevocable trust, the purpose of the trust must be considered. If the purpose is to exclude assets from estate taxes, then the grantor of the trust should not receive any benefits, including those from a qualified LTC policy. However, if the purpose is not to exclude assets from estate taxes, or the grantor is not the insured, suitability and insurable interest exists. Therefore, the trust provisions should ensure that distributions for LTC benefits may be made.

The per diem limit for 2024 is \$410 a day and is typically adjusted annually for inflation.

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## Can premiums for the three LTC agreements of a SecureCare III policy be paid from an HSA?

Yes. Qualified LTC premiums for the three LTC agreements are included in the definition of an HSA's qualified medical expense. However, if premiums are paid from an HSA they are not income tax deductible.

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5. The long-term care payments are treated under Internal Revenue Code (IRC) Section 7702B(a) as received under a life insurance contract as reimbursement for expenses for medical care. A life insurance contract that has a long-term care insurance rider available, qualified or otherwise, will be deemed for the long-term care insurance rider to be treated as a separate contract under the IRC Section 7702B(e)(1). The Minnesota Life long-term care riders are qualified long-term care insurance contracts, and therefore would receive the favorable tax treatment indicated under IRC Section 7702B(a).

6. Under IRC Section 101(a). IRC Section 101(g) specifically states "any amount received under life insurance contract on the life of an insured who is a terminally or chronically ill individual shall be treated as an amount paid by reason of the death of an insured." Although long-term care payments from a rider on a life insurance contract are not paid "by reason of the death of the insured," IRC Section 101(g) allows tax-free receipt of the death benefit proceeds.

# Tax treatment of SecureCare III in the business setting

## A: Company-Owned:

In general, when a company/employer owns a SecureCare III policy and the benefits are paid under a Health Reimbursement Arrangement, the treatment of the benefits will be as follows:

- If an LTC claim is made, monthly benefits are paid to the company on an income tax-free basis.<sup>7</sup>
- The LTC payments that the company pays to the employee will be income tax-free, if paid in accordance with a Health Reimbursement Plan or a Welfare Benefit Plan.<sup>8</sup>
- The company may not take an income-tax deduction for life insurance premiums if it's a direct or indirect beneficiary of the policy.<sup>9</sup>

In addition, the company must be aware of, and incorporate, certain IRC requirements, including:

- Compliance with the Notice and Consent requirements under IRC section 101(j).
- ERISA and 409A consequences must also be considered.

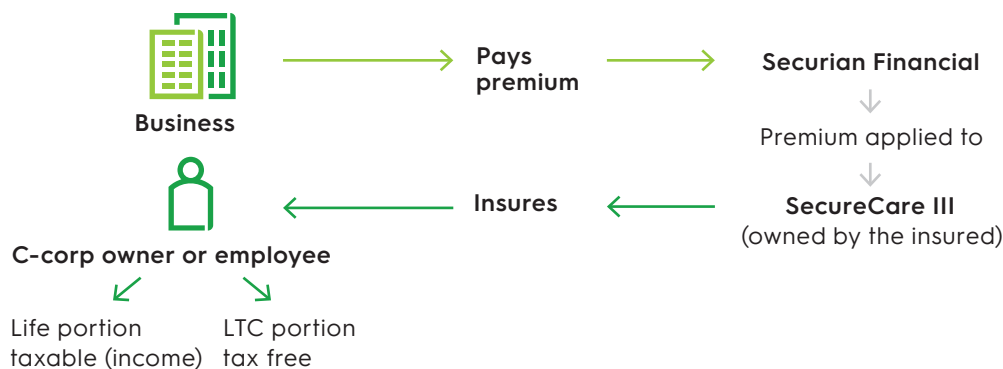
## B: Individual-Owned:

### 1) C corporation owners & Non-owner employees

In general, all LTC premiums paid for owners/shareholders and employees, and their spouses and tax dependents are deductible, and no age-based eligible premium limits apply.

#### How it works:

- Business pays a premium to Securian Financial.
- Securian Financial applies this premium to a SecureCare III policy owned by the insured. This policy insures the life of the C corporation owner or employee.
- The premium associated with the life insurance base policy (and premium waiver agreement if elected) would be considered taxable income to the employee. The portion of the premium that goes toward the three LTC agreements are considered tax free.



7. The Secure Care III product is a qualified long-term care insurance product as specified under IRC section 7702B.

8. The long-term care payments must be made to reimburse the participant/ employee for expenses paid for "medical care" as defined under IRC Section 213(d). "Qualified long-term care services" constitute "medical care" expenses. Internal Revenue Code Section 213(d)(1)(C) specifically refers to IRC Section 7702B(c) but does not refer to IRC Section 7702B(d), which allows the per diem model for individually owned products.

9. IRC Section 264. However, the SecureCare III product will have a portion of the "premium" that is specified as the qualified long-term care component. Therefore, a deduction for this component is likely respected. A "charge" for the long-term care costs on a hybrid life insurance contract may not be deducted.

## 2) Pass-through entities

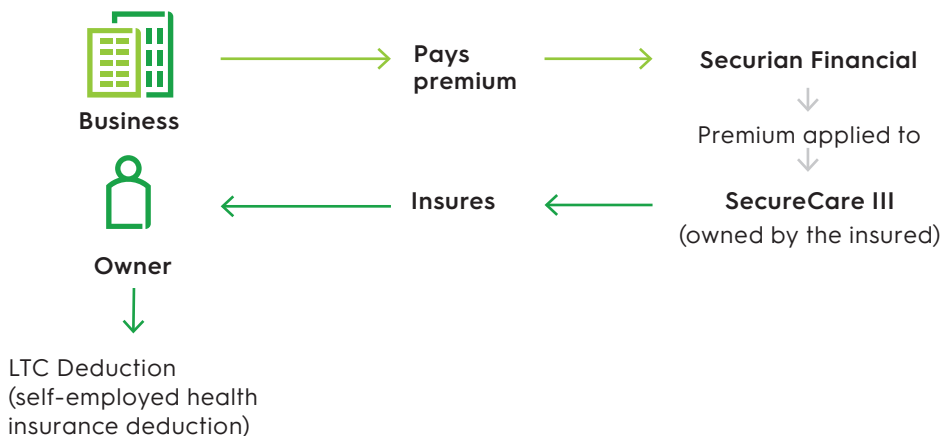
- **Sole proprietors and Partners in partnership:** may generally deduct whichever is less: the premium or the attained-age limit for the relevant year as a self-employed health insurance deduction.
- **S corporation owners:** may generally deduct whichever is less: the premium or the attained-age limit for the relevant year as a self-employed health insurance deduction. For an S corporation to claim a deduction for LTC coverage, the premiums must be paid by the business (premiums paid directly by the business or paid by the owner and reimbursed by the business).

### Taxation of premiums

Policy owner	Business tax deductions	Life and LTC premium payments included in income	Income tax deduction as self-employed health insurance
Sole Proprietor	Deduction for both portions as compensation	Yes	Yes
Partner in partnership	Deduction for both portions as guaranteed payments	Yes	Yes
S corporation owner & employee	Deduction for both portions as compensation	Yes	Yes

### How it works:

- Business pays a premium to Securian Financial.
- Securian Financial applies this premium to a SecureCare III policy owned by the insured. This policy insures the life of the pass-through business owner.
- Owner may deduct whichever is less: the portion of the premium that goes toward the three LTC agreements or the attained-age limit for the relevant year as a self-employed health insurance deduction.



Please keep in mind that the primary reason to purchase a life insurance product is the death benefit.

Life insurance products contain fees, such as mortality and expense charges, and may contain restrictions, such as surrender periods.

The optional Long-Term Care Inflation Protection Agreement is available with 3% simple interest, 3% compound interest, 5% simple interest or 5% compound interest.

Additional agreements may be available. Agreements may be subject to additional costs and restrictions. Agreements may not be available in all states or may exist under a different name in various states and may not be available in combination with other agreements.

SecureCare III may not be available in all states. Product features, including limitations and exclusions, may vary by state.

SecureCare III Universal Life Insurance includes the Acceleration for Long-Term Care Agreement. The Acceleration for Long-Term Care Agreement is a tax qualified long-term care agreement that covers care such as nursing care, home and community based care, and informal care as defined in this agreement. This agreement provides for the payment of a monthly benefit for qualified long-term care services. This agreement is intended to provide federally tax qualified long-term care insurance benefits under Section 7702B of the Internal Revenue Code, as amended. However, due to uncertainty in the tax law, benefits paid under this agreement may be taxable.

The death proceeds will be reduced by a long-term care or terminal illness benefit payment under this policy. Clients should consult a tax advisor regarding long-term care benefit payments, terminal illness benefit payments, or when taking a loan or withdrawal from a life insurance contract. Death proceeds will be reduced by outstanding loans and unpaid monthly deductions.

This information is a general discussion of the relevant federal tax laws provided to promote ideas that may benefit a taxpayer. It is not intended for, nor can it be used by, any taxpayer for the purpose of avoiding federal tax penalties. Taxpayers should seek the advice of their own advisors regarding any tax and legal issues specific to their situation.

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F95989-32 Rev 11-2023 DOFU 3-2022  
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