

# Annuities and LTC

*What you need to know...*

## What is the Pension Protection Act?

The Pension Protection Act, is a wide-ranging piece of legislation signed into law August 17th, 2006. While the majority of it deals with changes and reforms to pension governance, *Section 844 of the act deals specifically with annuities, long-term care and new tax advantages.*

## What does the Pension Protection Act Do for Annuities?

1. Beginning January 1, 2010, **cash value withdrawals from specific annuity contracts to pay for qualifying long-term care expenses or to pay qualified long-term care insurance premiums, will no longer be taxable income but considered as a reduction of cost basis.**
2. **Benefit payments from long-term care insurance riders will also not be taxable.**

*Note: "As a reduction of cost basis" means that distributions from the policy are non-taxable and reduce the owner's cost basis in the contract (but not below zero).*

## How does the Pension Protection Act do this?

- Pension Protection Act allows annuity contracts to include long-term care coverage and under new Code Section 7702B(e)(1), such coverage will be treated for tax purposes as a separate contract.
- By separating the annuity and LTC portions of the contract, it has become possible for the long-term care coverage to be qualified under section 7702B as set forth by the Health Insurance Portability and Accountability Act or HIPAA (Public Law 104-191).

Under new Code Section 72(e)(11), *premium charges associated with long-term care coverage that are distributed from the cash value of an annuity contract will not be treated as taxable distribution, but as a non-taxable reduction of cost basis.*

## What is HIPAA?

The Health Insurance Portability and Accountability Act (HIPAA), enacted in 1997, provides standards for a long-term care insurance policy to be considered federally qualified and established that claim payments from such plans are not subject to federal income taxation.

The primary difference between qualified and non-qualified long-term care insurance contracts is that the qualified contracts must satisfy several specific benefit and consumer protection requirements.

**IRC Section 7702B(b), created by HIPAA, requires that:**

- an individual must be receiving care pursuant to a plan of care prescribed by a licensed health care practitioner, and
- that the individual be certified by a licensed health care practitioner as being “chronically ill” by either being unable to perform at least 2 activities of daily living or requiring substantial supervision due to a severe cognitive impairment.

Long-term care insurance contracts must meet the guidelines of IRC Section 7702B(b) in order to be considered qualified.

**How do you know that an annuity meets HIPAA guidelines?**

Only annuities with provisions and riders that are “qualified” under IRC Section 7702B(b) are eligible for the benefits of the Pension Protection Act.

*An annuity contract with qualified long-term care coverage should contain language similar to the following on the initial policy page: “For taxable years beginning on or after January 1, 2010, this Contract is intended to be a federally qualified Long-Term Care insurance contract under Section 7702B(b) of the Internal Revenue Code of 1986 as amended.”*

**What are examples of annuities not considered qualified under HIPAA?**

The very common annuity riders such as “nursing home waivers” and other features that waive surrender charges because of a long-term care need or “chronic / terminal illness” typically will not meet HIPAA guidelines.

**How can you fund an annuity with long-term care provisions?**

Pension Protection Act provisions apply to annuity contracts funded **with after-tax premium sources**. Contracts funded with pre-tax sources such as IRAs, 401(k)'s, and 403(b)'s are excluded from the Pension Protection Act as set forth in IRC Section 7702B(e)(4).

**How will long-term care benefits be reported?**

Qualifying long-term care benefits and long-term care insurance premiums paid from annuity values, along with long-term care benefits paid from riders, will be reported at year-end on **Form 1099-LTC**.

Since the passage of HIPAA, when an insurance company pays a benefit under a long-term care insurance contract, the company is required to report the information to the IRS and the policy owner using Form 1099-LTC.

**When will new tax advantaged annuities be available?**

There are very few available for purchase today. It may be wise to take advantage of good health and purchase such a policy today and receive the benefits of the Pension Protection Act as soon as an unexpected care need arises.