

Executive Carve Out Using Long-Term Care Insurance

An Executive Carve Out plan can be used when a business decides to reward a specific group of executives by purchasing for each member in the group, a long-term care insurance policy. The executive or key employees are usually those who are key to the success of the business. By using an accelerated pay option such as a “ten pay,” the business can project the cost of this special benefit and determine when the premium payments will stop. When the executive retires the business can present him or her with a paid up long-term care insurance policy.

Whether the policy is limited pay or a continuous pay long-term care insurance policy, there are many advantages to this plan:

- The Executive is the owner of the policy and it is portable.
- The business can deduct the cost of the premiums using pretax dollars, just like health insurance.
- The total premium paid by the business is not included in the executive’s taxable income (unless the executive has an ownership interest in a pass-through business entity like a partnership, S corporation, LLC, etc.).
- Benefits under a tax-qualified long-term care insurance policy are paid to the executive tax free.

The discussion of legal and tax considerations in this material is an interpretation of current law and is not intended as legal or tax advice. Your clients should consult their legal and tax professionals.

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Long Term Care Insurance Specialists

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LTC Premium Deductibility Quick Reference Guide¹

| Type of Business | Circumstance | Deductibility |
|------------------------------------|--|---|
| Sole Proprietor | Employer pays premiums for employees' policies | Employer deducts 100% of premium expense. Premiums paid by employer not included in employee's taxable income. Benefits received from policy not included in recipient's taxable income. |
| | Sole Proprietor pays premiums for own policy. | Deducts lesser of actual premiums paid and eligible long-term care insurance premium (see chart below) ¹ . Benefits received from policy not included in recipient's taxable income. |
| Partnership | Employer pays premiums for employee's policies. | Employer deducts 100% of premium expense. Premiums paid by employer not included in employee's taxable income. Benefits received from policy not included in recipient's taxable income. |
| | Partnership pays premiums for partners' policies. | Premiums attributed to each partner included in their income. Partner deducts lesser of actual premiums paid and eligible long-term care insurance premium (see chart) ² . Benefits received from policy not included in recipient's taxable income. |
| C Corporation (includes charities) | Employer pays premiums for employee policies. | Employer deducts 100% of premium expense. Premiums paid by employer not included in employee's taxable income. Benefits received from policy not included in recipient's taxable income. |
| S Corporation | Employer pays premiums for employee's policies (including 2% and less shareholders). | Employer deducts 100% of premium expense. Premium paid by employer not included in taxable income. Benefits received from policy not included in recipient's taxable income. |
| | S Corporation pays premiums for greater than 2% employee or shareholders' policies. | Premiums attributed to each greater than 2% employee or shareholder are included in their income. Greater than 2% shareholder deducts lesser of actual premiums paid and eligible long-term care insurance premium (see chart below) ³ . Benefits received from policy not included in recipient's taxable income. |
| Limited Liability Corporation | Employer pays premium for employee's policies. | Employer deducts 100% of premium expense. Premiums paid by employer not included in employee's taxable income. Benefits received from policy not included in recipient's taxable income. |
| | LLC pays premiums for owner/members' policies. | Premiums attributed to each owner/member included in their income. Owner/member deducts lesser of actual premiums paid and eligible long-term care insurance premium (see chart below) ⁴ . Benefits received from policy not included in recipient's taxable income. |

Current tax law generally allows deductibility of qualified long-term care insurance premiums paid for policies covering an individual, his or her spouse, and dependents (when paid for outright or received in connection with employment). References under the "Circumstance" column to "Employer" and "Employee" refer to long-term care insurance premiums paid in the employment context as an employee benefit.

² IRC Sec. 162(1)(1)(B), Rev. Rul. 91-26, 1991-15 I.R.B. 23

³ IRC Sec. 162(1)(1)(B), Rev. Rul. 91-26, 1991-15 I.R.B. 23

⁴ IRC Sec. 162(1)(1)(B), Rev. Rul. 91-26, 1991-15 I.R.B. 23

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Eligible Long-Term Care Insurance Premiums Age-Based Deduction Limits

Tax Year 2007

| Age | Amount Deductible |
|---------------|----------------------|
| 40 or less | \$290* |
| 41 not yet 51 | \$550* |
| 51 not yet 61 | \$1,110* |
| 61 not yet 71 | \$2,950* |
| 71 or older | \$3,680* |

*Before end of taxable year

The age-based limits are indexed annually (to nearest \$10) to increases in the medical care cost category of the Consumer Price Index.

An individual taxpayer may deduct qualified long-term care insurance premiums subject to two limitations. First, any premiums greater than the above age-based limits are not deductible. Second, premiums under or equal to the above limits are deductible only to the extent that such premiums, together with any unreimbursed medical expenses the taxpayer has paid for himself or herself, his or her spouse, and dependents, exceed 7.5% of the taxpayer's adjusted gross income.

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¹ IRC Sec. 162(1)(1)(B).

² IRC Sec. 162(1)(1)(B), Rev. Rul. 91-26, 1991-15 I.R.B. 23

³ IRC Sec. 162 (1)(1)(B), Rev. Rul, 91-26, 1991-15 I.R.B. 23

⁴ IRC Sec. 162(1)(1)(B), Rev. Rul. 91-26, 1991-15 I.R.B. 23

⁵ IRC Sec. 213(d)(10)(A). Rev. Proc.2002-70, 46 I.R.B 1