John Hancock
LIFE INSURANCE

Advanced Markets

Because You Asked

Answers to Questions Frequently Asked of the Advanced Markets Team

The Pension Protection Act of 2006 and Taxation of Long-Term Care Insurance

In 2006, the Pension Protection Act of 2006 (PPA) was signed into law. In addition to sweeping changes to the laws controlling pensions and retirement plans, the PPA also amended the laws surrounding long-term care insurance. The PPA's changes were intended to encourage individuals to purchase long-term care insurance, by making it more tax favorable. The PPA changes for taxation of long-term care are about to take effect, as the PPA's specific amendments to long-term care insurance become **effective after December 31, 2009**. As the end of 2009 approaches, it is time to take another look at the PPA's coming changes to long-term care insurance.

How does the PPA treat long-term care riders on insurance and annuity contracts?

The PPA separates the benefits of the life insurance contract or the annuity contract from the benefits provided by the long-term care rider. The long-term care rider is treated as a separate contract, independent from the underlying life insurance or annuity contract, for purposes of determining whether it is "qualified long-term care insurance" and the taxation of the benefits provided under the long-term care rider.

Can the long-term care rider be added to a life insurance contract or to an annuity?

The PPA added specific language stating that the addition of a long-term care rider to a life insurance contract or to an annuity will not cause the life insurance contract or the annuity to fail to qualify as valid insurance or annuity contracts.

What if the long-term care rider is added to an annuity, will the rider charge be income taxable to me?

Prior to the PPA, the rider charge would be treated as a charge against the cash value in the contract which would be includable in the annuity owner's income. After the effective date of December 31, 2009, the rider charge against the cash value of the annuity contract will not be included in income but will reduce the basis in the annuity.

What if the long-term care rider is added to a modified endowment contract (MEC), will the rider charge be income taxable to me?

Prior to the PPA, the rider charge would be treated as a charge against the cash value in the contract which would be includable in the MEC owner's income, to the extent that there was gain in the contract. After the effective date of December 31, 2009, the rider charge against the cash value of the MEC will not be included in income but will reduce the basis in the MEC.

Can I do a tax-free Section 1035 exchange of a long-term care contract for a new long-term care contract?

The PPA added paragraph (a)(4) to Internal Revenue Code §1035, stating that after December 31, 2009, a long-term care contract can be exchanged tax-free for another long-term care contract.

Can I do a tax-free Section 1035 exchange of a life insurance policy or an annuity for a long-term care contract?

The PPA has amended IRC §1035(b), effective after December 31, 2009, to allow the tax-free exchange of an annuity contract or a life insurance contract for a long-term care contract. The exchange of an annuity contract for a life insurance contract is still prohibited under IRC §1035.

Can I do a tax-free Section 1035 exchange of a life insurance contract for a life insurance contract with a long-term care rider?

The PPA has amended IRC §1035(b) and after December 31, 2009, it will be possible to do a tax-free exchange of a life insurance contract for a life insurance contract with a long-term care rider.

Can I do a tax-free Section 1035 exchange of an annuity contract for an annuity contract with a long-term care rider?

The PPA has amended IRC §1035(b) and after December 31, 2009, taxpayers will be able to do a tax-free exchange of an annuity contract for an annuity contract with a long-term care rider.

If I have a Governmental Retirement Plan can I use distributions from that plan to pay for long-term care insurance?

Any individual who is an eligible retired public safety officer who makes the election may take a distribution of up to $3,000 to pay for long-term care insurance for the employee or the employee's spouse. Such distribution will not be included in the employee's taxable income for the year. The PPA uses the definition in Section 1204(8)(A) of the Omnibus Crime Control and Safe Streets Act of 1968 (42 U.S.C. 3796b(9)(A)) for determining an "eligible public safety officer".