BULLETIN:

Helping a Client Use an HSA to Pay Long Term Care Insurance Premiums

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States: **All**

Important Note:
Using a Health Savings Account (HSA) to pay for LTCI premiums can be an attractive option for some of your clients, but make sure they understand the tax considerations and other limitations.

Contact: Questions? Please contact your Genworth LTCI Sales Team.

If you have clients who own a Health Savings Account (HSA) or are eligible to open one, they may be able to use pre-tax dollars from the account to pay for all or part of their Long Term Care Insurance (LTCI) premiums. Using an HSA to pay for LTCI premiums may be an attractive option for clients who are not eligible to deduct their premiums as either a self-employed person or as unreimbursed medical expenses on their federal income tax returns.

Let's Look at an Example

Your client, Dean Barker, age 52, is looking for a tax-advantaged means of paying his LTCI premiums. He doesn't own a business, so he can't deduct premiums as a self-employed person[1]. He has also checked with his accountant and has been told he won't be able to deduct his premiums as unreimbursed medical expenses. Is there another option available to him? If he owns an HSA or is eligible to open one, he may be able to use pre-tax dollars from that account to pay his LTCI premiums.

Deducting Long Term Care Insurance Premiums

Getting a federal income tax break on the payment of LTCI premiums can be difficult. Here's why: Qualified LTCI premiums paid by an individual taxpayer for policies owned by him or herself, or by his or her spouse and eligible dependents, are deductible medical expenses (IRC §213(d)), but only if that taxpayer itemizes deductions, and then only to the extent that eligible premiums (the lesser of the age-based limit premiums [see below] and actual premiums paid), plus all other unreimbursed medical expenses, exceed 7.5% of the taxpayer's adjusted gross income (IRC §213(a)). *In other words, few people can actually take advantage of all or even part of this deduction.*

(continued)

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Long term care insurance products issued by Genworth Life Insurance Company and in New York by Genworth Life Insurance Company of New York.
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The HSA Alternative

Another way to pay for LTCI premiums is through an HSA. Not everyone qualifies for an HSA, and even for those who do, using the account to pay LTCI premiums isn't always an option. Let's look at how it can be done.

HSA Eligibility: The first step is to verify that your client has an existing HSA or is eligible to open one. The general qualifications are as follows:

- The individual must be covered by a high-deductible health plan. A high-deductible health plan has an annual deductible of at least $1,200 for individuals, $2,400 for families (2011 limits, adjusted for inflation) and annual out-of-pocket limits not exceeding $5,950 for individuals and $11,900 for families (2011 limits, adjusted for inflation).
- Even if an individual has a high-deductible health plan, he or she cannot contribute to an HSA if they are also (i) covered under a non-high-deductible health plan or a plan that duplicates benefits of their own plan, such as a spouse's plan through the spouse's employer[2], (ii) claimed as a dependent on another's income tax return, or (iii) covered by Medicare.

HSA Contribution Limits

- For 2011, the maximum annual contribution amount is $3,050 for individuals and $6,150 for families (limits decreased by aggregate contributions to an Archer MSA).
- Eligible individuals over age 55 may also make additional catch-up contributions each year. The catch-up contribution amount for 2011 is $1,000. This amount is currently not scheduled for inflation adjustments in future years.

HSA Tax Considerations

- Employer HSA contributions are not included in the employee's income (pre-tax). This includes contributions to an employee's HSA by their employer using the amount of the employee's salary reduction made through an IRC §125 cafeteria plan.
- An individual can take an above-the-line deduction for eligible contributions they make to their HSA.
- Any growth inside an HSA is tax-free if withdrawals are made for qualified medical expenses.
- Distributions that are not made for qualified medical expenses are included in taxable income and are subject to a 20% penalty tax (non-qualified distributions prior to 2011 were subject to 10% penalty tax). The penalty tax does not apply if the distributions are made after death, disability, or attaining age 65.

Other HSA Considerations

- If the HSA is funded by employer contributions, the employer must comply with the "comparability" requirements of IRC §4980E[3].
- If an individual is eligible to contribute to an HSA on the first day of the last month of the tax year (December 1, for most people), they can make the full annual contribution. If an individual is no longer eligible on that date, their contributions apply pro rata based based on the number of months during the year they were eligible.
- An individual may make a one-time tax-free transfer (trustee-to-trustee) from their traditional or Roth IRA to their HSA in the amount of the maximum deductible contribution they could make to their HSA (IRC §408(d)(9)).
- Unlike Flexible Spending Accounts, HSA balances are not forfeited if not withdrawn by the end of the year.

Using an HSA to pay LTCI Premiums

Qualified LTCI premiums are a qualified medical expense. As a result, an individual may withdraw money tax-free from their HSA to pay qualified LTCI premiums. Qualified LTCI premiums are the eligible premiums (lesser of actual premiums paid and the "age-based" premium limits shown below). Therefore, only the qualified LTCI premiums may be withdrawn tax-free from an HSA.

Example:

Dean Barker owns an HSA and contributed $3,000 to it in 2011.

Dean also owns a Genworth Life Insurance Company LTCI policy. His annual premiums are $2,500. His eligible age-based premiums are $1,270. Because Dean's eligible premiums are a qualified medical expense for HSA purposes, he may withdraw up to $1,270 tax-free from his HSA in 2011 to pay towards his LTCI premiums. The balance of his LTCI premium, $1,230, is not a qualified medical expense, and he may not withdraw HSA funds to pay for it or otherwise deduct it.

AGE-BASED LONG TERM CARE INSURANCE PREMIUMS

Age at End of Taxable Year	2011 Premium Limit Amount
40 or younger	$340
41 through 50	$640
51 through 60	$1,270
61 through 70	$3,390
71 and older	$4,240

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[1] A self-employed person may deduct eligible premiums for accident and health insurance, including LTCI premiums they pay for themselves, their spouse and other eligible dependents. They need not consider the 7.5% of AGI threshold for deductibility of medical expenses (IRC §162(l)).

[2] However, you can still be eligible if the additional insurance is limited to providing benefits only for certain specified coverage items (including long term care) IRC §223(c)(1)(B).

[3] IRC §4980G incorporates the comparability rules of §4980E by reference (Treas. Reg. §54.498G-1, A-1).