



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

The Honorable Melissa A. Hart
U.S. House of Representatives
Washington, D.C. 20515

Dear Ms. Hart:

This letter is in response to your inquiry dated March 19, 2002, requesting clarification on the federal tax treatment of benefits received under a long-term care (LTC) insurance contract that is not a "qualified" LTC contract.

Because long-term care insurance plans are not uniform, we cannot make blanket rulings or general statements as to whether benefits received under these plans meet the necessary requirements to be excluded from gross income. While we have not published any formal guidance on this issue, I can give you the following information on sections of the Internal Revenue Code (the Code) that apply to LTC insurance contracts.

Qualified LTC Insurance Contracts Must Meet Requirements of Section 7702B of the Code

An insurance contract must meet the requirements of section 7702B of the Code to qualify as a qualified long-term care insurance contract. A qualified LTC insurance contract only provides benefits when an individual is unable to perform at least two of six specific "activities of daily living." If an insurance contract meets the requirements of section 7702B, the benefits received are generally excluded from gross income with an exclusion limitation (indexed for inflation) for payments made on a per diem or other periodic basis which are made without regard to the expenses incurred for qualified long-term care services.

For contracts that do not meet the requirements of section 7702B, the Congress has stated, "Contracts or services that do not meet HIPAA's requirements (i.e., non-qualified LTC) continue to be subject to the prior-law rules." Joint Committee on Taxation, Description of Federal Tax Rules and Legislative Background Relating to Long-Term Care (JCX-18-01), March 26, 2001.

Insurance Contracts that Do Not Meet the Requirements of Section 7702B Are Subject to Prior-Law Rules

Policies that do not meet the requirements of section 7702B are not defined in the Code and must meet the general requirements of section 104(a)(3) (i.e., "prior-law rules") to be excluded from gross income. Under this section, benefits are not included in the recipient's gross income if they:

- (1) Are received through an accident or health arrangement
- (2) Are payable for personal injuries or sickness

This section excludes from gross income amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts paid by or attributed to contributions by an employer for its employees.)

Some plans do not qualify under section 7702b, but do meet the section 104(a)(3) requirements. On the other hand, some contracts do not meet the requirements of section 104(a)(3) because they provide a form of prepaid retirement benefits or may not be considered insurance. We cannot make that determination without a detailed analysis of the specific provisions of the insurance policy.

We recognize the current statutory situation makes it difficult for taxpayers to determine the taxability of benefits under policies that do not meet the requirements of section 7702B. However, any taxpayer whose tax liability is affected by the tax treatment of benefits received under a specific contract can get a definitive answer through the private letter ruling process. Rev. Proc. 2002-1, 2002-1 I.R.B. 1 outlines the procedures for obtaining a private letter ruling.

Current law makes it impossible for us to issue a definitive ruling on the exclusion from gross income of benefits received under various nonqualified LTC insurance plans. The resolution of this issue will most likely require legislation. Therefore, I am forwarding your letter to the Office of Tax Policy of the Department of Treasury for review and appropriate action.

We hope this information is helpful. If you need additional information, please contact me or Shoshanna Chalton of my staff at (202) 622-3567.

Sincerely,

Harry Baker
Chief, Health & Welfare Branch
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt & Government Entities)

cc: The Office of Tax Policy
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