Advanced **Markets**

Because you asked

Long-Term Care (LTC) riders

This piece addresses some of the most frequently asked questions concerning long-term care riders associated with life insurance contracts and is meant to provide a general overview of long-term care riders, state-specific law and exceptions have not generally been considered or addressed.

INSURANCE PRODUCTS	
MAY LOSE VALUE	NOT A DEPOSIT
NOT BANK GUARANTEED	NOT FDIC INSURED
NOT INSURED BY ANY GOVERNMENT AGENCY	

LIFE-5124 8/24

LTC rider

1. What is a long-term care rider?
2. What are the primary differences between an indemnity and a reimbursement LTC rider?
3. Can an LTC rider's rates be increased?
4. What is an elimination period?
5. If the owner of a policy with an LTC rider goes on claim, are premiums still due on the policy?
6. How do LTC benefit payments affect the cash value of the insurance contract?

LTC rider and third-party ownership

7. Are there tax issues associated with third-party ownership of a life insurance contract with an LTC rider?
8. Does John Hancock allow third-party ownership of an LTC rider?
9. Can a life policy with an LTC rider be owned in a trust?
10. Can a life policy with an LTC rider be owned by a business?

Chronic illness and critical illness riders

11. What is a chronic illness rider?
12. What is a critical illness rider?

Tax

13. How are amounts received from a qualified LTC rider treated for income tax purposes?
14. Is the tax treatment of qualified LTC benefits different for a life policy classified as a modified endowment contract (MEC)?
15. Are premium payments associated with an LTC rider tax deductible?
16. Is the cost of insurance for an LTC rider considered a taxable distribution?
17. Can a taxpayer exchange a life insurance contract for a life insurance contract with an LTC rider tax-free under §1035?
18. Are benefits received from an LTC rider or chronic illness rider reportable to the IRS?

LTC rider

1. What is a long-term care rider?

A long-term care (LTC) rider is a rider attached to a permanent life insurance policy that accelerates the death benefit to help pay for the costs of long-term care services for chronically ill insureds.[1] To qualify as an LTC rider, the services required by a chronically ill individual must be provided pursuant to a plan of care prescribed by a licensed health care practitioner. An individual is considered chronically ill if they are unable to perform at least two of six Activities of Daily Living (ADLs) without substantial assistance from another person for at least 90 days due to a loss of functional capacity.[2] An individual may also be considered chronically ill if they need substantial supervision to protect their health and safety because of a severe cognitive impairment.

Generally, when LTC benefits are paid from an LTC rider, the death benefit available on the policy is reduced dollar for dollar; such benefit payments also reduce cash value to some degree (see question #6). At the insured's death, the remaining portion of the death benefit (that was not used to pay LTC benefits) will be paid to the beneficiaries on a tax-favored basis.

For most LTC riders, the LTC benefit payable is limited to a maximum monthly benefit — determined based on a percentage of the death benefit or the per diem limit determined by the IRS from year to year, depending on the type of rider.

2. What are the primary differences between an indemnity and a reimbursement LTC rider?

LTC riders available today fall under one of two benefit payment models: reimbursement or indemnity. The following are the primary differences between the types of riders:

A *reimbursement rider* pays LTC benefits based on the eligible LTC expenses incurred by the insured, limited only by the maximum monthly benefit prescribed in the contract. This type of rider allows the policy owner to receive benefit payments in excess of the IRS per diem limit without adverse tax consequences. Under a reimbursement rider, the LTC rider payment will be paid directly to the policy owner unless the owner elects to have the care provider[3] paid directly. For example, with an assignment of benefits, the insurance carrier[4] can obtain invoices directly from care providers and pay them, removing the policy owner/family from the reimbursement process altogether. John Hancock's LTC rider is a reimbursement rider.

An *indemnity rider* pays LTC benefits based on the maximum monthly benefit allotted under the rider regardless of the amount of actual long-term care expenses incurred by the insured. Most carriers offering an LTC indemnity rider limit the monthly benefit to the lesser of (i) a percentage of death benefit or (ii) the IRS per diem limit.[5] For 2024, the IRS per diem limit is $410/day ($420 in 2023). If benefits are paid above the IRS per diem limit, the policy owner may be taxed on the excess amount unless they can show the benefits were spent on qualified long-term care expenses. In practice, most carriers, like John Hancock, cap the amount of benefits that may be paid at the per diem limit to avoid potential taxation issues. As a result, the monthly benefit percentage chosen is not necessarily payable or available to the policy owner.

With indemnity riders, submitting invoices to the carrier may not be required to receive benefits, but the policy owner (or policy owner's family) will have to manage billing and payments to the care providers.

Example

Compare how benefits are received under a reimbursement rider versus an indemnity rider:

John owns a life insurance policy with an LTC rider that has a $750,000 death benefit with a 4% monthly benefit option — i.e., $30,000/month.

Reimbursement rider

In January 2024, John has $15,000 in LTC expenses and will receive $15,000 in LTC benefits. The next month, when John's LTC expenses are $8,000, he will receive $8,000 in LTC benefits and the unused $7,000 will remain in the policy. This can help extend the LTC coverage period.

Indemnity rider

In January 2024, John has $15,000 in LTC expenses and will receive $12,710 ($410 x 31 days) in LTC benefits. The next month, when John's LTC expenses are $8,000, he will receive $11,480 ($410 x 28 days) in benefits.

In either case, the $750,000 death benefit will be reduced by the amount of LTC benefits accelerated dollar for dollar.

This is a hypothetical example for illustrative purposes only.

LTC rider, continued

3. Can an LTC rider's rates be increased?

The answer depends on the carrier. For LTC riders issued by John Hancock, the rate is set at issue and is guaranteed not to increase over the life of the policy. The rider charge is based on an amount per $1,000 of the Net Amount at Risk. When the Net Amount at Risk changes, the LTC rider charge will change accordingly. For example, as the Net Amount at Risk decreases while LTC benefits are being paid, the LTC rider charge also decreases. The guaranteed rate per $1,000 of Net Amount at Risk does not change.

Many carriers do not have guaranteed rates for LTC riders, which means the rider rate can be increased.

4. What is an elimination period?

An elimination period is the number of days that must pass after an insured is considered eligible for LTC benefits, but before payments begin. Elimination periods vary among LTC riders, which impact their cost, just as deductibles impact premiums for other types of insurance. Typically, the elimination period is counted in dates of service or in calendar days.

John Hancock's LTC rider has an elimination period that is 90 calendar days. This means once the insured is certified as chronically ill the elimination period begins and will end after 90 consecutive days pass. Insureds are not required to receive qualified long-term care services during the elimination period.

Some riders require that qualified long-term care services are received during the elimination period. It is essential to understand how a carrier defines the elimination period to understand when it begins, when LTC benefits will be payable and how often it must be satisfied. John Hancock's elimination period only needs to be satisfied once. Some carriers require multiple elimination periods if there is a break in LTC services or for each LTC claim.

5. If the owner of a policy with an LTC rider goes on claim, are premiums still due on the policy?

This depends on the carrier and the product. For life insurance policies with LTC riders issued by John Hancock, all policy and rider charge deductions continue while on claim, and premiums may still be due. If there is sufficient cash value in the policy, future premium payments may not be required. Keep in mind that as LTC benefits are being paid, the Net Amount at Risk decreases which means the charges associated with the LTC rider — as well as the policy — are reduced.

6. How do LTC benefit payments affect the cash value of the insurance contract?

This depends on the carrier. When an insured goes on claim and LTC payments are made, many carriers reduce the policy/cash value in the contract dollar for dollar. John Hancock reduces the policy's cash value or policy value proportionally instead.

Example showing how the face amount and cash value may be affected:

- Total face amount (at time of claim): $250,000
- Policy/cash value (at time of claim): $50,000
- Maximum monthly benefit for LTC: $5,000

LTC benefits paid are $5,000 each month. Each month, the total face amount will be reduced by the benefit payment dollar for dollar; and the policy/cash value will be reduced in proportion to the amount of the payment. The Net Amount at Risk also decreases.

	Month 1	Month 2
Total face amount calculation	$250,000 – $5,000 = $245,000	$245,000 – $5,000 = $240,000
Policy/cash value calculation	$50,000 x $245,000 / $250,000 = $49,000	$49,000 x $240,000 / $245,000 = $48,000
Net amount at risk decrease	From $200,000 to $196,000	From $196,000 to $192,000

This is a hypothetical example for illustrative purposes only.

LTC rider and third-party ownership

7. Are there tax issues associated with third-party ownership of a life insurance contract with an LTC rider?

Neither §7702B (governing long-term care contracts) nor §104 (specifying income tax treatment of payments received for injuries or sickness) specifically prohibit third-party ownership of a life insurance policy with an LTC rider or receipt of LTC benefit payments.

While there are strong arguments for the favorable tax treatment of policies with an LTC rider owned by a third-party, there is no specific guidance from the Internal Revenue Service as to the tax effects of such third-party ownership. **This is true whether the LTC rider is classified as a reimbursement or an indemnity rider.**

Given the current lack of guidance regarding the ramifications of third-party ownership, there is the risk that such ownership structure could cause adverse income, estate, and/or gift tax consequences. Therefore, the client should seek tax and legal counsel to review the particulars of an intended ownership arrangement in light of the income, gift, and estate tax provisions of the Internal Revenue Code. A life insurance policy with an LTC rider should only be purchased by or transferred to a person other than the insured after all parties have carefully reviewed the issues with their own tax and legal professionals.

8. Does John Hancock allow third-party ownership of an LTC rider?

Yes. John Hancock will issue life insurance policies with an LTC rider for most ownership scenarios, although some restrictions apply. For example, third-party ownership is not allowed inside a qualified plan and with some business-owned policies (see question #10). Additionally, John Hancock does not allow third-party ownership with an LTC rider in New York based upon our understanding of §41.8 of NY Insurance Regulation 143.

In states where a person or an entity other than the insured owns the policy, John Hancock requires completion of the *Third-Party Ownership Disclosure — Long-Term Care Riders* (NB5193). This Disclosure outlines the uncertain tax consequences and encourages clients to seek the advice of legal counsel.

9. Can a life insurance policy with an LTC rider be owned in a trust?

Yes, a trust can own a policy with an LTC rider, but depending on the type of trust being used (i.e., irrevocable or revocable) there are planning nuances and considerations to be aware of. Trusts should be drafted by an attorney familiar with such matters to take income and estate tax laws (including the generation-skipping transfer tax) into account. Failure to do so could result in adverse tax treatment.

Revocable trust

The trustee can typically use the accelerated death benefit received to pay the care providers directly. In the case of a reimbursement contract, like John Hancock's, the trustee can assign the benefit payment directly to the care provider.

Irrevocable life insurance trust (ILIT)

Ownership of a life insurance policy with an LTC rider inside an ILIT is permitted (except in New York); however, the accelerated death benefit should only be paid to the owner of the contract (i.e., the trustee) and cannot be used directly to pay for the insured's care. John Hancock's reimbursement rider will automatically pay any acceleration of death benefit for long-term care needs to the owner of the contract (e.g., the ILIT trustee). As such, LTC benefit payments made directly to the ILIT trustee/owner should maintain the integrity of the trust, similar to an indemnity rider.

For both indemnity and reimbursement riders owned by an ILIT, care should be taken so that the terms of the trust don't inadvertently cause inclusion in the estate (if trying to be avoided) and the insured must understand that there is no direct access to this money for LTC purposes. Use of accelerated funds, however, may be used to repay trust beneficiaries for expenses paid on behalf of the insured (assuming the trustee can make current distributions under the trust terms) or may be lent to the insured if the trust doesn't prohibit such loans.

In cases where estate tax exclusion is a top planning priority, personal ownership or a two-policy approach may be recommended. For example, some practitioners may recommend purchasing a smaller, privately-owned policy with an LTC rider and a larger, trust-owned policy without an LTC rider.

LTC rider and third-party ownership, continued

10. Can a life insurance policy with an LTC rider be owned by a business?

Yes, however, the tax implications of third-party ownership of a policy with an LTC rider are not entirely clear, (see question #8).

Code §101(g)(5), which relates to payments received for chronic illness as an acceleration of death benefit, provides that amounts received by a business will not be exempt for income tax purposes when the business "has an insurable interest with respect to the life of the insured by reason of the insured being a director, officer, or employee" of the business or by reason of the insured being "financially interested" in the trade or business carried on by the business. Although Code §101(g) is believed to apply to chronic illness riders (see question #11) and not to LTC riders qualified under §7702B, there are some instances where state law may require an LTC rider to qualify under both §7702B and §101(g) of the Internal Revenue Code.

While there is no comparable taxation language associated with business-related policies in §7702B (or §104, which addresses taxation of payments received from accident and health plans), there is no authority that addresses the intersection of §101(g) and §7702B. Accordingly, clients should always seek tax and legal counsel to review the particulars of an intended ownership arrangement in light of the income, gift, and estate tax provisions of the Code.

John Hancock will consider applications for business-owned policies with an LTC rider on a case-by-case basis.

Home

LTC rider

LTC rider and third-party ownership

Chronic illness and critical illness riders

Tax

Disclosures

Chronic illness and critical illness riders

11. What is a chronic illness rider?

A chronic illness rider is another type of rider that allows for the acceleration of death benefit from an insurance contract governed by IRC §101(g). **Chronic illness riders cannot be marketed or referred to as long-term care insurance since they do not satisfy the requirements of IRC §7702B, which governs long-term care insurance products.**

The definition of "chronic illness" can vary among chronic illness riders. While the NAIC amended its model regulations on accelerated death benefit riders to no longer require a condition be "permanent," some chronic illness riders do, thereby excluding conditions that may be recoverable — such as mild to moderate strokes, orthopedic repairs, etc. In these cases, a physician must certify that the insured's chronic illness is expected to last the rest of their life.[6] As such, temporary claims that may be covered under an LTC rider may not be covered under a chronic illness rider that requires permanency of a condition.

Another important distinction that can arise with chronic illness riders is the determination of benefit. Many chronic illness riders can be added to a policy with no upfront cost and without any additional underwriting. The charges for these riders are determined and applied when the insured initiates a claim. This is done through a reduction of the accelerated benefit payment, or the death benefit is subject to a lien. In either case, the amount of death benefit available for chronic illness payment may be less than the face amount and may not be determinable prior to claim. John Hancock's Accelerated Death Benefit for Chronic Illness rider applies the charge at time of claim and will reduce the accelerated death benefit payment to the policy owner.

Chronic illness riders, unlike LTC riders, are not required to include consumer protection provisions, such as lapse protection and reinstatement. Therefore, it is important to read the contract to understand what protections may or may not be offered.

Lastly, in terms of taxation, §101(g) of the Code generally provides that the death benefit accelerated on behalf of a chronically ill individual will be received income tax-free — similar to an LTC rider. However, in the case of a third-party owner, there may be instances where such acceleration is not received income tax-free. Section 101(g)(5) provides that amounts received by a business will not be exempt from income taxes when the insured is a director, officer or employee (see question #10). Additionally, amounts accelerated may be subject to income taxes if the "payee" (i.e., the policy owner) has not incurred the costs for expenses for which the acceleration of the death benefit is related (i.e., the payee is not actually paying expenses on behalf of the insured.)[7]

12. What is a critical illness rider?

A critical illness rider pays a benefit if the insured is diagnosed with a covered critical illness, such as cancer, heart attack, or a stroke.

Some carriers offer a critical illness rider as an acceleration of death benefit, meaning the policy owner can accelerate either all or a portion of the death benefit in a lump sum. If the entire portion is accelerated, the life policy will terminate; if only a portion of the amount is accelerated, the policy will remain in force with a reduced death benefit. Like some chronic illness riders, critical illness riders can be added to a policy with no upfront cost or underwriting, and the charges and benefit amount will be determined at claim time.

John Hancock's Critical Illness Benefit rider (CIBR) is unique as it is not an acceleration of the death benefit — the benefit it pays is in addition to the death benefit. John Hancock's CIBR pays a one-time, lump sum, income tax-free benefit up to $250,000 upon initial diagnosis of a covered critical illness. Because it is a separate benefit, the payment will not jeopardize the death benefit pool, preserving it for beneficiaries and/or a long-term care need if applicable — which is especially important at a time when insurability could very well be compromised.

Although neither §101(g) nor §7702B makes any mention of benefits received for "critical illness," there is some guidance by way of Private Letter Rulings issued by the IRS indicating that benefits received under a critical illness rider should be received free of income tax under other Code provisions.[8]

John Hancock will treat the monthly rider charges as distributions from a life insurance policy for federal income tax purposes, and thus such charges may be includable in a policy owner's taxable income if the policy is a MEC or the cost basis is less than the rider charges. If the policy is a MEC, a 10% penalty tax may also apply to the amount includable in income.

John Hancock anticipates that the benefit paid under the CIBR will generally be excludable from income under Internal Revenue Code §104(a)(3). However, the benefit may not qualify for this exclusion with certain third-party ownership arrangements.

Home

LTC rider

LTC rider and third-party ownership

Chronic illness and critical illness riders

Tax

Disclosures

Tax

13. How are amounts received from a qualified LTC rider treated for income tax purposes?

A "qualified" LTC rider is a rider that meets the requirements specified in §7702B, the same Code section that governs stand-alone LTC insurance policies. Per §7702B(e), qualified LTC insurance riders associated with life insurance policies shall be treated as separate long-term care contracts. Accordingly, the accelerated death benefit from a life insurance contract with an LTC rider should receive the same tax treatment as stand-alone qualified long-term care insurance contracts.[9]

Code §104(a)(3) generally provides that amounts received for personal injuries or sickness are not includable in gross income. Because amounts received from qualified long-term care insurance generally qualify as "amounts received for personal injuries and sickness" per §7702B(a), the death benefit accelerated from a life policy with a qualified LTC rider is generally received income tax-free.

Most LTC riders, like John Hancock's, are intended to be "qualified" long-term care insurance contracts under Code §7702B(b).

The tax treatment of the amounts received for LTC expenses paid from a qualified LTC rider generally is the same whether the contract reimburses for actual long-term care expenses (a reimbursement benefit) or pays a per diem amount toward long-term care (an indemnity benefit). However, if an indemnity contract pays a benefit that exceeds the IRS per diem limit, the excess is taxable income to the extent it exceeds actual qualified LTC expenses incurred. This means tracking benefit dollars to determine how much was spent paying for qualified LTC services to avoid a situation where these benefits are considered taxable income.

When multiple LTC contracts are owned on a single insured, the payments received are combined for the purposes of determining whether amounts received exceed the greater of total LTC expenses incurred by the insured or the per diem limit.[10]

14. Is the tax treatment of qualified LTC benefits different for a life policy classified as a modified endowment contract (MEC)?

No. Even if the policy is classified as a MEC, the intent is for the LTC benefit payments to be excludable from income. There is nothing in the tax code or the regulations that provides for a different tax result for qualified LTC benefits received from a MEC.

15. Are premium payments associated with an LTC rider tax deductible?

The answer depends on how premiums associated with an LTC rider are structured. IRC §7702B(e) prohibits a tax deduction for LTC rider premium payments when such payments are made as a charge against the cash surrender value of a life insurance contract. When the LTC rider charge is applied to the cash surrender value, a deduction would not be available.

However, where the LTC rider premium is not structured as a charge against cash surrender value, a deduction may be available, if:

(1) the individual taxpayer itemizes their deductions and to the extent that those deductions, along with other unreimbursed medical expenses (including Medicare premiums), exceed 7.5% of their adjusted gross income; then (2) the individual taxpayer's "eligible LTC premiums" as specified in Code §213(d)(10) can be deducted; any excess premiums cannot.

For 2024, the "eligible LTC premiums" are as follows:

Attained age before the close of the taxable year	Limitation on premiums
40 or less	$470
More than 40 but not more than 50	$880
More than 50 but not more than 60	$1,760
More than 60 but not more than 70	$4,710
More than 70	$5,880

16. Is the cost of insurance for an LTC rider considered a taxable distribution?

No. For tax years after December 31, 2009 (effective date of the Pension Protection Act of 2006), an LTC rider charge that's made against the cash value of an insurance policy is not included in income, but will reduce the cost basis in the contract (not below zero).[11] This rule applies whether or not the life insurance contract is classified as a MEC.

When an LTC rider charge is made against the policy's cash value, the policy owner will receive a 1099-R annually from the carrier reporting the LTC rider charge and reduction of basis in the contract. This 1099-R is required by the Pension Protection Act and is simply informational; no tax should be due, nor will the policy owner need to report these amounts on their tax return.

Tax, continued

17. Can a taxpayer exchange a life insurance contract for a life insurance contract with an LTC rider tax-free under §1035?

Yes, after December 31, 2009, §1035 permits a tax-free exchange of a life insurance contract for a life insurance contract with an LTC rider.

18. Are benefits received from an LTC rider reportable to the IRS?

Yes. When accelerated benefits are received by a taxpayer from an LTC rider, the IRS requires the insurance company issue a Form 1099-LTC. Form 1099-LTC reports the gross amount of long-term care benefits paid and identifies whether the benefits are paid *per diem* or as *reimbursement* for LTC expenses actually incurred.

When accelerated benefits are received as reimbursement, then no further action is required. However, if the accelerated benefits are received as a per diem (i.e., payments were made on any periodic basis without regard to actual expenses incurred), then the taxpayer must complete Form 8853 and file it with their income tax return each year benefits are received. Form 8853 is used to help calculate the taxable amount (if any) associated with per diem payments received by the taxpayer from these contracts.

1. See IRC §7702B(b) and (c).
2. See IRC §7702B(c)(2)(B). The six ADLs are: bathing, continence, dressing, eating, toileting, and transferring.
3. Not all care providers may qualify for direct payments. See contract for details.
4. See John Hancock LTC rider contract.
5. IRC §7702B(d).
6. NAIC Model Regulation 620, Accelerated Benefits Model Regulation, §2(B). Model Regulation 620 requires that "accelerated benefits" be paid out upon the occurrence of a "qualifying event." See §2(B) for other qualifying events other than a medical condition that is expected to last for the rest of the insured's lifetime.
7. For example, the language in IRC §101(g)(3) that "such payment is for costs incurred by the payee" suggests that third-party ownership of an LTC rider may put at risk the payment's favorable income tax treatment of an accelerated death benefit under §101(g).
8. PLRs 200339015, 200339016, 200627014, and 200903001. Private Letter Rulings are not binding authority for taxpayers other than the taxpayer to whom the ruling is issued.
9. See also §101(g), which provides favorable tax treatment for amounts received as an acceleration of death benefit for chronically ill individuals.
10. IRC §7702B(d) and associated regulations; see also IRS Form 8853 and Instructions.
11. IRC §72(e)(11).

FOR AGENT USE ONLY. THIS MATERIAL MAY NOT BE USED WITH THE PUBLIC.

The Accelerated Death Benefit for Chronic Illness rider allows for a partial acceleration of the death benefit when the insured is certified as chronically ill. The amount is capped at 75% of the death benefit to a lifetime maximum of $1 million. The annual maximum benefit amount is limited to the IRS per diem limit. Accelerated benefit payments under this rider reduce the death benefit dollar for dollar by the accelerated amount and reduce the policy value proportionately. The payments will also be reduced by interest charges. The benefits provided by this rider are designed to be excludable from gross income under federal tax law; however, there might be situations in which the benefits or charges for this rider are taxable.

The Critical Illness Benefit rider provides a one-time lump sum benefit for covered critical illnesses subject to eligibility requirements. The benefit will not be paid for critical illnesses initially diagnosed before the rider effective date or during the waiting period. See the product producer guide for additional details.

The Long-Term Care (LTC) rider is an accelerated death benefit rider and may not be considered long-term care insurance in some states. There are additional costs associated with this rider. The Maximum Monthly Benefit Amount is $50,000. When the death benefit is accelerated for long-term care expenses it is reduced dollar for dollar, and the cash value is reduced proportionally. Please go to www.jhsaleshub.com to verify state availability.

Insurance policies and/or associated riders and features may not be available in all states.

This rider has exclusions and limitations, reductions of benefits, and terms under which the rider may be continued in force or discontinued. Consult the state-specific Outline of Coverage for additional details.

This material does not constitute tax, legal, investment or accounting advice and is not intended for use by a taxpayer for the purposes of avoiding any IRS penalty. Comments on taxation are based on tax law current as of the time we produced the material.

All information and materials provided by John Hancock are to support the marketing and sale of our products and services, and are not intended to be impartial advice or recommendations. John Hancock and its representatives will receive compensation from such sales or services. Anyone interested in these transactions or topics may want to seek advice based on his or her particular circumstances from independent professionals.

Insurance products are issued by: John Hancock Life Insurance Company (U.S.A.), Boston, MA 02116 (not licensed in New York) and John Hancock Life Insurance Company of New York, Valhalla, NY 10595.

©2024 John Hancock. All rights reserved.

MLINY120823374-1