Leading off - PPA Basics

The Pension Protection Act, also known as Public Law 109-280, is a wide-ranging piece of legislation that was signed into law August 17, 2006. While the majority of it deals with changes and reforms to pension governance, Section 844 of the act deals specifically with annuities, long-term care and new tax advantages.

Since January 1, 2010, cash value withdrawals from *specific annuity* contracts to pay for qualifying long-term care expenses or to pay qualifying long term care insurance premiums, are no longer taxable income but considered as a reduction of cost basis. Benefit payments from long-term care insurance riders are also not taxable.

"A reduction of cost basis" means that distributions from the policy are non-taxable and reduce the owner's cost basis in the contract (but not below zero).

The Pension Protection Act allows annuity contracts to include long-term care coverage and under new Code Section 7702B(e)(1), such coverage will be treated for tax purposes as a separate contract. By separating the annuity and LTC portions of the contract, it has become possible for the

The primary difference between qualifying and non-qualifying long-term care insurance contracts is that the qualifying contracts must satisfy several specific benefit and consumer protection requirements. IRC Section 7702B(b), created by HIPAA, requires that an individual must be receiving care pursuant to a plan of care prescribed by a licensed health care practitioner, and that the individual be certified by a licensed health care practitioner as being "chronically ill" by either being unable to perform at least 2 activities of daily living or requiring substantial supervision due to a severe cognitive impairment.

Long-term care insurance contracts must meet the guidelines of IRC Section 7702B(b) in order to be considered qualifying.

Only annuities with provisions and riders that are "qualifying" under IRC Section 7702B(b) are eligible for the benefits of the Pension Protection Act. An annuity contract with qualifying long-term care coverage should contain language similar to the following on the initial policy page: "For taxable years beginning on or after January 1, 2010, this Contract is intended to be a federally qualifying Long-Term Care insurance contract under Section 7702B(b) of the

long-term care coverage to be qualifying under section 7702B as set forth by the Health Insurance Portability and Accountability Act or HIPAA (Public Law 104–191).

Under new Code Section 72(e)(11), premium charges associated with long-term care coverage that are distributed from the cash value of an annuity contract will not be treated as taxable distribution, but as a non-taxable reduction of cost basis.

An important component of this is understanding a little about the Health Insurance Portability and Accountability Act (HIPAA). HIPAA was enacted in 1997, and set standards for a long-term care insurance plan to be considered federally qualifying and established that benefit payments from such qualifying plans are not subject to federal income taxation.

Internal Revenue Code of 1986 as amended."

The Pension Protection Act only applies to annuity contracts funded with after-tax premium sources. Contracts funded with pre-tax sources such as IRAs, 401(k)'s, and 403(b)'s are excluded from the Pension Protection Act as set forth in IRC Section 7702B(e)(4).

Qualifying long-term care benefits and long-term care insurance premiums paid from annuity values along with long-term care benefits paid from riders will be reported at year-end on Form 1099-LTC. Since the passage of HIPAA, when an insurance company pays a benefit under a long-term care insurance contract, the company is required to report the information to the IRS and the policy owner using Form 1099-LTC.