The Pension Protection Act and Long-Term Care

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The Pension Protection Act (PPA) signed into law Aug. 17, 2006, deals with changes and reforms to pension governance. Section 844 of the act deals specifically with annuities, long-term care (LTC) and new tax advantages.

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Beginning on Jan. 1, 2010, cash value withdrawals from specific annuity contracts to pay for long-term care expenses were no longer classified as taxable income but are considered as a reduction of cost basis. 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 PPA 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 LTC coverage to be qualified under section 7702B as set forth by the Health Insurance Portability and Accountability Act, or HIPAA.

HIPAA set standards for a LTC insurance plan to be considered federally qualified and established that benefit payments from such qualified plans are not subject to federal income taxation.

Only annuities with provisions and riders that are "qualified" under IRC Section 7702B are eligible for the benefits of the PPA. An annuity contract with qualified LTC coverage should contain language stating so. The PPA 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 PPA.

A qualified long-term care contract must satisfy several specific benefit and consumer protection requirements. IRC Sec. 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 two activities of daily living for 90 days or requiring substantial supervision due to a severe cognitive impairment.

With a PPA compliant annuity, you will have the benefits of LTC insurance if you need them. If you don't have a need or only need some protection, your annuity's cash accumulation value will go to your named beneficiaries. So, if you don't use it, you don't lose it.

By a 1035 exchange (tax-free) from a current annuity for a PPA compliant annuity, you may be better matched with a vehicle that will meet your needs while providing a tax advantage. With the PPA annuity there is no medical exam, however it is medically underwritten. So it is best to apply while you are still healthy.

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