Financial Services - Insurance Tax Bulletin

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Stock life insurance company's long-term care rider will be treated as insurance contract

In PLR 201213016, the Service ruled that a long-term care benefits rider (Rider) added to single premium deferred annuity contracts offered by a stock life insurance company will be treated as an insurance contract under Section 7702B(b)(1).

Taxpayer is a stock life insurance company taxable under Section 801 and is the issuer of certain annuity contracts, which include a single premium deferred annuity contract. The annuity contract is not a variable contract within the meaning of Section 817(d). Taxpayer proposes to offer a non-cancellable rider option ("Rider") to provide certain long-term care benefits (LTC Benefits) during the time the person covered by the Rider is a chronically ill individual with the meaning of Section 7702B(c)(2) and receiving qualified long-term care services within the meaning of Section 7702B(c)(1) through the agency or facility identified in the plan of care.

Section 7702B(b)(1) states that a qualified long-term care insurance contract is "any insurance contract" that has certain characteristics. The Internal Revenue Code does not define the terms "insurance" or "insurance contract." Through several case rulings, the Supreme Court has explained that in order for an arrangement to constitute insurance for federal income tax purposes, both risk shifting and risk distribution must occur. In order to demonstrate that the Rider qualified for treatment as an insurance contract, Taxpayer demonstrated that there was a possibility that a specific insured could incur a loss reimbursable by the Rider. If there were never any reasonable possibility of reimbursement for a loss to a specific insured, the Rider would not constitute insurance. In this case, the insured has a risk of economic loss if that person suffers "prolonged morbidity," meaning that he/she becomes chronically ill. Through the Rider, the taxpayer assumes the risk that the insured will be eligible for long-term care benefits. The risk assumed by Taxpayer will be distributed across the large number of insureds who purchase the Rider. The

Rider conforms to the definition of insurance in the commonly accepted sense. Accordingly, the Service concluded that the Rider constitutes an insurance contract for purposes of Section 7702B(b)(1).

Section 104(a)(3) provides in relevant part that gross income does not include amounts received through accident or health insurance for personal injuries or sickness. Section 7702B(a)(1) states that a qualified long-term care insurance contract shall be treated as an accident and health insurance contract. Section 7702B(a)(2) states that such amounts received under a qualified long-term care insurance contract shall be treated as amounts received for personal injury and sickness. As such, since the Rider constitutes an insurance contract under Section 7702B(b)(1) and otherwise satisfies the requirements for a qualified long-term care insurance contract under Section 7702B, the Service concluded that LTC Benefits paid under the Rider are excludable from gross income under Section 104(a)(3).

PwC Observation

This is yet another example of how the Service continues to focus on determining that products that purport to be insurance, meet the required standards.

***For further information**, please feel free to contact Anthony DiGilio at (703) 918-4812 or contact your local insurance tax professional.*

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