TAX ADVANTAGES OF LONG TERM INSURANCE

Long-term care insurance is a tough sell these days because many Americans find it difficult to commit to years of premium payments toward an uncertain future for something they may never need.

However, the looming tidal wave of 70 million retiring baby boomers has prompted federal and state governments to sweeten the long-term care deal by offering tax incentives to those who purchase long-term care insurance, hoping to lessen the potential drain on Medicaid resources.

The recent decision by Health and Human Services to shelve the Community Living Assistance Services and Supports, or CLASS Act, portion of health care reform ironically may help insurers get the word out about the tax advantages of owning a long-term care policy.

"Most people are not aware of the tax deductibility of long-term care insurance," says Jesse Slome, executive director of the American Association for Long-Term Care Insurance. "People who have been waiting for the CLASS Act to come riding to the rescue, well, that's not going to happen right now. But there is good news: Long-term care premiums are tax deductible and the limits went up again this year. That is good news."

If you've been on the fence about long-term care insurance, here are six long-term care insurance tax breaks that may affect your decision.

Individual deduction

For individuals, the Internal Revenue Service considers tax-qualified long-term care premiums a medical expense. To what degree that will save you money on your taxes largely depends on your age and how you make a living.

If you work for someone else and itemize your deductions, you can deduct your long-term care premiums under medical expenses on Schedule A. However, because the long-term care insurance portion is capped by age and because only the portion of your total medical expenses that exceeds 7.5 percent of your adjusted gross income is deductible, few employed individuals realize a full deduction on their long-term care premium.

"It's not really a great deduction because you would have to have a whole bunch of medical expenses before you can even get to the long-term care premium being deductible," says Scott A. Olson, a long-term care insurance agent based in Redlands, Calif.

However, Slome points out that since the long-term care cap increases with age (at 40, the 2012 limit is $350; at 60, it's $3,500), as health problems arise later in life, the long-term care deduction becomes more meaningful.

"As your medical expenses increase, when you add your LTC insurance into it, that could put you over the 7.5 percent," he says. "It may not happen when you're young, but down the road where you're more likely to have other medical expenses, it may all become deductible."

Self-employed deduction

The tax advantages of a long-term care policy ramp up sharply if you're self-employed. Rather than listing your premiums on Schedule A, they go directly on line 29 ("Self-employed health insurance deduction") on Form 1040.

"It's a great deduction because it comes off the top of your income," says Olson. "That could mean $900 to $1,000 a year in reduced taxes if you're in a 28 percent tax bracket."

James Sullivan, a CPA and personal financial specialist based in Naperville, Ill., says the self-employed can reduce their taxable income substantially. "In addition, you can include eligible premiums paid for your spouse and dependents," he says.

An extra incentive for part-timers and work-from-home parents: You don't have to be self-employed full time to enjoy the deduction, Olson says.

Maryland State Tax Credit

Residents of Maryland are eligible for a state tax credit of up to $500 for the first year of the policy. Keep in mind this is a credit and not a deduction so it is like getting a rebate of up to $500 for the first year of your premium. This benefit is available to individuals and the self-employed.