EPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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Dear :

This responds to your letter dated January 16, 2004, in which you request a private letter ruling about the income tax consequences of long-term care insurance premium payments. As of this office discussed with you on April 28, 2004, the Internal Revenue Service ordinarily does not issue a private letter ruling when the taxpayer's question involves a factual issue. See § 6.02 of Rev. Proc. 2004-1, 2004-1 I.R.B. 1, 15. Whether is a factual issue. Moreover, the Service will not issue a private letter ruling on whether compensation is reasonable in amount. See § 3.01(15) of Rev. Proc. 2004-3, 2004-1 I.R.B. 114, 116. Accordingly, we decline to issue a ruling. Pursuant to § 15.10(2) of Rev. Proc. 2004-1, your user fee will be refunded under separate cover. Although we decline to issue a ruling on your questions, we are happy to provide you with general information regarding the deductibility and income treatment of long-term care insurance.

You relate the facts as follows: You are a . You are and perform services for a partnership owned by . You currently receive payments from the partnership under a covenant not to compete. The partnership wishes to pay you a salary and purchase a long-term care insurance policy on your behalf. The premium for the insurance policy is expected to be $ per year. All hired by the partnership in future will be eligible for the long-term care insurance coverage.

You ask whether the partnership may deduct the long-term care insurance premiums in full; whether there are any requirements regarding minimum salary and hours for a person to constitute an employee of the partnership; and whether you have taxable income as a result of the insurance coverage.

Deductibility of Long-Term Care Insurance Premiums

Section 162(a) of the Internal Revenue Code provides that a business may deduct its ordinary and necessary expenses paid or incurred during the taxable year. Employee compensation is an ordinary and necessary expense under § 162(a)(1) to the extent that the compensation is: 1) For services actually rendered, and 2) reasonable in relation to the services performed. Payments for employee health plans, including long-term care insurance plans, are usually considered employee compensation. See Publication 535, “Business Expenses,” pages 7 and 25 (copy enclosed).

There are no specific requirements regarding a minimum salary or minimum hours worked to determine what constitutes a reasonable amount of employee compensation under § 162(a)(1). Section 1.162-7(a) of the Income Tax Regulations states that the test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. Section 1.162-7(b)(3) defines reasonable compensation as only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. See also Publication 535, pages 6 and 7.

If a payment designated as compensation is not in exchange for services actually rendered, the payment is not deductible under § 162(a)(1). On the other hand, if an employee renders services but the compensation exceeds an amount that would be considered reasonable, the compensation is deductible under § 162(a)(1) only to the extent that it would be reasonable.

Tax Consequences to the Insured Person

Generally, an employer’s payments for qualified long-term care insurance premiums for an employee are excluded from the employee’s income. See Publication 525, ”Taxable and Nontaxable Income,” page 4 (copy enclosed). For the requirements for qualified long-term care insurance contracts and eligible premiums, see Publication 535, page 25. Similarly, non-business payments made for another person’s long-term care insurance premiums may be gifts from the payor to the insured person, and if so, are excluded from the insured person’s income under § 102.

In addition to an employer’s payment of premiums on behalf of the insured person, amounts the insured person receives under a qualified long-term care insurance contract for qualified long-term care are usually excluded from the insured person’s income. See Publication 525, page 15.

I hope this information is helpful. For your convenience, a copy of Publication 334, "Tax Guide for Small Businesses," also is enclosed. If you have any questions, please contact , I.D. Number , at .

Sincerely,

Paul M. Ritenour
Chief, Branch 1
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (3):
- Publication 535, Business Expenses
- Publication 525, Taxable and Nontaxable Income
- Publication 334, Tax Guide for Small Businesses