HANSEN HUNTER & CO. P.C.
Certified Public Accountants

NEWSLETTER

December 29, 2014

NURSING FACILITY COSTS, LONG-TERM CARE SERVICES AND INSURANCE PREMIUMS DEDUCTIBLE AS MEDICAL EXPENSES

We are often asked about the deductibility of long-term care costs (assisted living facilities, nursing homes, etc.) as a medical expense on Form 1040 - Schedule A. This newsletter briefly summarizes the relevant rules for this tax deduction, as well as providing a quick glimpse at the deductibility of long-term care insurance premiums for the 2014 tax year.

MEDICAL CARE

If an individual is in a long-term care facility which provides medical treatment, such as an assisted living center or skilled nursing facility, then the determination as to the amount of the costs which are tax deductible depends on the reason for the individual being at the facility. Each person's situation must be evaluated separately.

> If an individual is in a facility because of a physical condition, and the availability of medical care is a principal reason for admission, then the entire cost of the care (including meals and lodging) is deductible as a medical expense. Generally a resident will have medical care as a principal reason for admission when they are in an assisted living facility or a skilled nursing facility.
>
> If medical care is not a principal reason for being in the facility, then only the portion of the cost attributable to medical or nursing care is deductible (**unless the rules below apply**).

QUALIFIED LONG-TERM CARE SERVICES

Another category of tax deductible medical expenses, called "qualified long-term care services", allows for the deduction of medical expenses that are due to cognitive impairment or diminished mental capacity, as well as those that are due to purely physical ailments. The qualifications for this deduction are discussed below.

Qualified long-term care services include necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, as well as maintenance or personal care services. Expenses incurred to provide these services are deductible only if the following two criteria are met:

The services are required by a “chronically ill individual” *and* they are provided under a plan of care prescribed by a licensed health care practitioner.

A "chronically ill individual" is one who has been certified, by a licensed health care practitioner within the previous 12 months, as:

(a) being unable to perform (without substantial assistance from another individual) for a period of not less than 90 days, at least <u>two</u> of the "activities of daily living" due to a loss of functional capacity. Activities of daily living are: 1) **eating**, 2) **toileting**, 3) **transferring**, 4) **bathing,** 5) **dressing,** and 6) **continence**.

or

(b) having a similar level of disability as determined by the IRS in consultation with the Department of Health and Human Services,

or

(c) requiring substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment.

> **NOTE**: An individual who is physically able, but who has a cognitive impairment such as Alzheimer’s disease or another form of irreversible loss of mental capacity, is treated similarly to an individual who is unable to perform (without substantial assistance) at least two activities of daily living. This was reaffirmed in Estate of Lillian Baral, et al. v. Commissioner, 137 T.C. 1, Code Sec(s) 213; 7702B.

An individual who meets these requirements may take a tax deduction for these costs as medical expenses on Form 1040, Schedule A.

<u>OTHER ITEMS TO NOTE</u>

The above medical costs are only deductible to the extent they exceed 10% of adjusted gross income (AGI) in 2014. However, for 2014, 2015, and 2016, if either the taxpayer or the taxpayer’s spouse turns 65 before the end of the tax year, the threshold is reduced to 7.5% of AGI.

In determining your total medical costs, be sure to include costs that you incur for your dependents as well as for yourself. For example, a taxpayer paying for the long-term care of an elderly parent or grandparent may be able to include these costs along with their own on their tax return. The costs may be included if the parent or grandparent is the taxpayer's dependent. For these purposes, the dependency test will generally be met if the taxpayer is providing over 50% of the support for the parent or grandparent (including medical costs). You may not be able to claim a dependency exemption if the parent or grandparent has gross income above $3,950 ($4,000 in 2015) or is filing a joint return, but you will still be able to include the medical costs that you pay on their behalf with your own.

QUALIFIED LONG-TERM CARE INSURANCE

"Qualified long-term care insurance" is insurance that:

- provides coverage only for qualified long-term care services,
- does not pay costs that are covered by Medicare,
- is guaranteed renewable, and
- does not provide for a cash surrender value.

A policy is not disqualified merely because it pays benefits on a per diem or other periodic basis without regard to the expenses incurred during the specific payment period.

Qualified long-term care insurance premiums are deductible as medical expenses, subject to certain limitations. Although the allowable amount varies significantly with age, it may be possible to deduct up to $4,660 in insurance premiums per taxpayer in 2014 and $4,750 per taxpayer in 2015. This amount is indexed annually for inflation.

The tax laws referred to above include many complex rules and definitions; therefore, each person should consult their tax advisor regarding the proper application of these laws to their individual tax situation.