Taking the Medical Expense Tax Deduction for Baby Boomers

& Seniors too!

Are you claiming all Medical Expenses on your Tax Return?

By Tina M. Kleckner EA, CAA

Notice: As of December 4, 2017, any further editing and processing of this booklet has ceased due to new tax legislation (Tax Cuts and Jobs Act) that is progressing through Congress which may impact the medical expense deduction claimed on tax returns for tax years after 2017. Thus, information provided in this booklet pertains to current tax year and is for informational purposes only.

Tax Law Change: On December 22, 2017, the Tax Cuts and Jobs Act was signed into law by the President. Although not totally eliminated, medical expenses are deductible for tax years 2017 and 2018 once they exceed 7.5% of Adjusted Gross Income (AGI). Tax years 2019 and beyond, medical expenses are deductible once in excess of 10% AGI. This information is pursuant to Section 11027(f)(2) of H.R.1 Tax Cuts and Jobs Act that is an Amendment to the Internal Revenue Code of 1986.

Purpose:

As the baby boomers are aging, out of pocket medical expenses paid are also increasing. And, yes, you can deduct many of these on your tax return! The purpose of this booklet is to provide information on which medical expenses are deductible and by whom is the deduction claimed on the tax return. This booklet contains the following Chapters:

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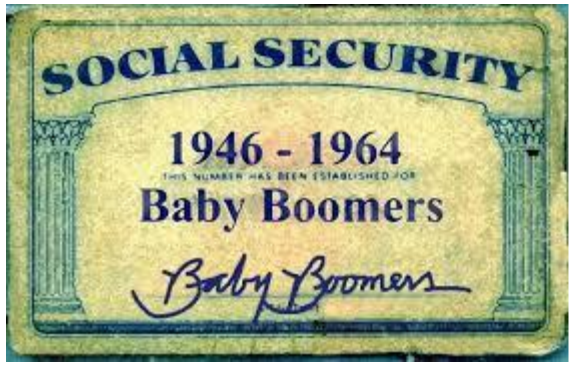

The aging of the baby boomers is creating a dramatic shift in the age composition of the U.S. population. Projections of the entire older population (which includes the *pre*-baby-boom cohorts born before 1946) suggest that 71.4 million people will be age 65 or older in 2029. This means that senior citizens age 65 and older will make up about 20 percent of the U.S. population by 2029, up from about 14 percent in 2012.

As your age increases, so may your medical expenses, which may be deductible on your tax return for the out of pocket medical expenses that exceed 10% of your Adjusted Gross Income (AGI). Your AGI is the very last line on page 1 of Form 1040. So as your medical expenses increase and become more than 10% of your AGI, it is to your advantage to know what is considered a medical expense and thus deductible on your tax return.

I hope you find the information contained in this booklet to be informative and useful for your tax situation. Direct questions can be emailed to: info@integrityintaxllc.com with the name of this booklet in the Subject line.

Thank you for reading!

Tina

Part I: What is considered a Medical Expense?

Let's start with medical care you pay for during the year known as your out of pocket costs. Medical care[1] is defined as an amount paid for (1) the diagnosis, cure, mitigation, treatment, or prevention of disease, or for a purpose affecting the body's structure or function; (2) transportation primarily for and essential to medical care; (3) qualified long-term care services; and (4) insurance for medical care or any qualified long-term care insurance contract. Thus, most medical care that is paid out of pocket is tax deductible.

Following is a list of expenses that, if incurred for medical reasons, are tax deductible:

1. Telephone equipment for hearing impaired
2. Removable air conditioner in the ill person's room
3. Service animal (include training and maintenance expenses)
4. Special hand controls for a car or van
5. Hearing aid (includes cost to repair)
6. TV equipment to display the audio portion of a programs subtitles for the deaf or hearing impaired
7. Meals
8. Lodging
9. Transportation
10. Cost of capital expenditures on the home to accommodate a medical need
11. Long-term care facilities
12. Nursing home costs
13. In-home care costs
14. Retirement community entrance fee
15. Premiums paid for insurance
16. Prepaid medical insurance

This list is not all inclusive, but as you can see, there are probably expenses on this list that you wouldn't have thought about as being deductible on your tax return. Items 7-16 are discussed in greater detail in this booklet. A complete list as provided in Table 4-1 of IRS Publication 554, Tax Guide for Seniors, can be found in Appendix 1 of this booklet.

[1] Per Internal Revenue Code (IRC) Section 213(d)(1).

Meals: Yes, the cost of meals is tax deductible if your main reason is to receive medical care.

Lodging: The cost of lodging other than hospitals is tax deductible as a medical expense provided the following are met:

1. Lodging is primarily for and essential to, obtaining medical care,
2. Medical care is provided by a licensed health professional in a licensed hospital or medical care facility,
3. Cost is not lavish or extravagant, and
4. There is no significant element of personal recreation, pleasure, or travel while away from home.

It has become common for people to travel for medical care whether it be to a larger city, facility with specialists in the area of medical treatment being sought, or to obtain second opinions.

The amount you can deduct for lodging is $50 per night per person. This includes the lodging for a person traveling with the person who is receiving medical care.

Example: Ryan and Heather travel 4 hours to see a specialist for their daughter's medical condition. Ryan and Heather stay overnight at the local motel close to the medical facility. Ryan and Heather can deduct $50 per person per night that they stay in the hotel relating to their daughter's medical care, which is $150 per night.

Transportation: The cost you incur to drive for medical purposes is also tax deductible. You can deduct one of two ways: 1) Actual out of pocket expenses such as gas and oil (but not maintenance, repair, insurance, and depreciation), or 2) Standard mileage rate that is set by the IRS. The current standard mileage rate for medical purposes is $.17 per mile. Regardless which method you choose, it is best practice to keep a written journal of the miles traveled for medical purposes.

You can also include the following as tax deductible transportation expenses incurred for medical expenses:

- Parking fees and tolls
- Bus, taxi, train, or plane
- Ambulance

2018 Change: IRS has announced standard mileage rates for 2018. The mileage rate for medical purposes is $.18 per mile.

Capital Expenditures: Yes, the cost you incur to make your home accessible to your medical needs may be a tax deduction. However, believe it or not there are two kinds of capital expenditures: (1) Those that increase the home value; and (2) Those than do not increase the home value. Typically, expenditures that increase the home value can only be taken in the amount above the increase in home value.

Example: As prescribed by the health care provider, George installed central air conditioning in his home with a special filtration system. The system plus installation cost George $4,000. The air conditioning system increased the home value by $1,000. Therefore, George can deduct $3,000 ($4,000-$1,000) as a medical expense. Also, the costs spent on maintenance, repairs, upkeep of the central air conditioning system and special filtration are tax deductible as medical expenses.

The second form of capital expenditures that can be a medical deduction are those that do not increase the home value. Generally, costs of this nature are ramps, modification to steps, and automated chair lifts. Because these costs do not increase the home value, the full cost is deductible as a medical expense.

Example: Sarah's house has a patio with steps to the front door. Because she is no longer able to go up the five steps, she has a ramp installed. The ramp plus installation cost $6,000. Since this does not increase the home value, Sarah can deduct the full $6,000 paid as a medical expense.

New Construction: One pitfall many baby boomers and seniors may fall into is the construction of a new home such as downsizing to a smaller home or purchasing a condo or duplex. The question becomes, when are the medical expenses to the new home deductible and by what amount?

The answer is that medical expenses are deductible in the year the home becomes habitable in the amount that exceeds the home's fair market value. This means all medical expenses are deductible, in the year you move into your newly built home. The deduction taken for medical expenses, is the difference between the actual cost to build and the home's fair market value.

Example: Roger and Jane can no longer live in their 2,000 square foot 2-story home because of their medical needs. Therefore, Roger and Jane build a small, 1-story, quaint home on the edge of town. Throughout construction which begins in 2016 and ends in 2017, it is estimated that $10,000 is spend on items due to their medical needs. When the home was complete in 2017, it cost $120,000 to build but only has a fair market value of $110,000. Roger and Jane moved into the home as soon as construction was complete. Therefore, Roger and Jane can report a medical expense deduction of $10,000 on their 2017 tax return.

This guidance stems from a Minnesota District court case[2] which determined the following:

1. The home provides no medical benefit until it is habitable, and
2. The amount of the deduction could not be ascertained until after the home was complete, since the deduction was the difference between actual cost of construction and the homes fair market value.

Personal property items, other than the home, qualify as a medical expenses deduction if they are directly related to the sick or disabled person and are expended for a medical reason per Treasury Reg. 1.213-1(e)(1)(iii).

Long-term care facilities: Under the Internal Revenue Code (IRC), medical expenses include amounts paid for long-term care. Because these expenses can be quite large, the understanding of their tax deductibility is very important. The deductibility of expenses paid to long-term care facilities depends on the particular needs and impairments of the person and the services provided to that person, rather whether the person receives medical care or whether the long-term care facility is qualified to provide medical care. This is of significance to the baby boomer population because these expenses can be quite high, resulting in significant deductions.

Long-term care facilities may also be considered medical expenses and tax deductible if amounts are paid for qualified long-term care services according to IRC Sec. 213(d)(1). This includes services that are necessary such as diagnostic, preventative, therapeutic, curing, treating, mitigating, and rehabilitation services that are required by a chronically ill person and are provided pursuant to a plan of care prescribed by a licensed health care practitioner.[3]

A licensed health care practitioner is typically a physician, registered nurse, or licensed social worker.

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[2] Zipkin Zipkin, Lawrence S. 86 AFTR 2d 2000-7052 2000-2 USTC 50,863 DC MN 2000

[3] IRC Section 7702B(c)

So just what is a chronically ill person you are probably thinking. For tax purposes, a chronically ill person is one that has:

- Been certified within the last 12 months by a licensed health care practitioner as:
    a. Being unable to perform at least two activities of daily living, known as ADL (see below), or
    b. Requiring substantial supervision to protect their safety or health caused by the person's severe cognitive impairment (onset of dementia or Alzheimer's).[4]

Activities of Daily Living (ADL): These are our normal functions that most of us take for granted such as eating, toileting, transferring, bathing, dressing, and continence without substantial assistance from another person.

Fortunately, the IRS issued Notice 97-31 which provides additional guidance of when a person is chronically ill by defining the above as either of the two: (1) ADL Trigger (Activities of Daily Living Trigger) or (2) Cognitive Impairment Trigger as defined below:

ADL Trigger: Substantial assistance is required from another person to perform any of the six activities of daily living. Substantial assistance as defined by Notice 97-31 includes hands-on or standby assistance from a person that is within arm's length of the person needing assistance. Additionally, according to this notice, a licensed health care professional must certify that the person is unable to perform two or more ADL's for a minimum of 90 days.

Cognitive Impairment Trigger: Substantial supervision by another person is required to protect the person's health and safety. The person must also have signs of severe cognitive impairment which is a loss of intellectual capacity that is comparable to dementia and Alzheimer's disease. This can be measured by standardized tests performed by health care professionals that reliably measure impairment of memory, orientation, and reasoning.

Amounts paid to long-term care facilities are deductible as medical expenses provided the person meets the definition of chronically ill as defined by IRS Notice 97-31 and the costs are prescribed by a licensed health care professional.

Whether the long-term care facility actually provides medical care is not a requirement for the cost of the long-term care facility to be deducted as a medical expense.

Tip: Long-term care facilities should not be confused with long-term care insurance premiums which are generally deductible subject to limitations (see later).

[4] IRC Section 7702B(c)(2)

Nursing home facilities: Expenses paid to a nursing home qualify as a medical expense if they meet one of the two following conditions:

1. Medical care requirement per the tax code[5], or
2. Qualified long-term care services as described in the above section.

Generally, expenses more easily meet the requirement of qualified long-term care services rather than the definition of medical care.

In-Home medical care: As human nature has it, we generally do not like change, therefore, many baby boomers and seniors will opt to remain in their home and have a private nurse or qualified professional assist them in the home. In-home medical care expenses are deductible as a medical expense if they meet one of the two following conditions:

1. Medical Care, or
2. Long-term care services of a person that is determined to be chronically ill by a licensed health care professional.

These expenses are deductible as a medical expense only if they are performed by a nurse, or other qualified professional even if not a licensed nurse. However, care provided by family members such as a spouse or children are not deductible as medical expenses unless the person providing the care is a licensed health care professional.

Those who choose this route of in-home medical care need to also be aware of whether the in-home caretaker qualifies as a household employee and therefore additional tax filing requirements may apply. Additional information can be found in the Appendix 2 to this booklet.

Premiums paid for insurance: Yes, deductible medical expenses on your tax return can also include premiums paid for insurance that covers medical care expenses. These premiums can be paid for anyone on the tax return – yourself, spouse, and/or dependents.

[5] IRC Reg. 1.213-1(e)(1)(v)

It is important to note that if the insurance policy provides coverage in addition to medical care such as loss of limb, sight, or life, ***only*** the medical care portion of the premium is tax deductible and ***must*** be separately stated and reasonable in respect to the total insurance premium.

> Tip: It is a good idea to include a list of medical insurance premiums when meeting with your tax professional so that a possible deduction is not missed. We recommend using a worksheet such as that in Appendix 3, when each bill is paid, you record on the worksheet. Therefore, at year-end you will have all out of pocket medical expenses that you paid during the year.

The most common types of premiums paid for medical insurance are the following:

1. Out of Pocket – After Tax Medical Insurance (Supplemental Insurance)
2. Prepaid Medical Insurance
3. Long-term Care Insurance

To explain these in greater detail -

1. Out of pocket – After Tax Medical insurance: This is also known as supplemental insurance that people have in addition to other insurance. Many people have supplemental medical insurance. This is especially common for those who are age 65 and on Medicare. Because Medicare may not pay for all medical expenses incurred, a supplemental insurance generally pays for the amount not covered by Medicare.

   > Tip: If you are self-employed, you generally can deduct the cost of premiums paid. These costs are deducted on page 1 of Form 1040 Line 29.

2. Prepaid Medical Insurance: It has become common for people under age 65 to pay premiums for medical insurance that will cover themselves, spouse, and/or dependents after they are age 65. These type of insurance premiums are tax deductible in the year paid if they are paid in equal installments for a minimum of 10 years or until the person is age 65 (but must be paid for atleast five years).

3. Long-term care insurance: This insurance is commonly referred to as contracts. These premiums can be tax deductible as a medical expense but are limited. The tax deduction is subject to your age on December 31. For 2017, the maximum deduction is as follows[6]:
   a. Age 40 or under - $410
   b. Age 41 to 50 - $770
   c. Age 51 to 60 - $1,530
   d. Age 61 to 70 - $4,090

[6] Rev. Proc. 2016-55

e. Age 71 & over - $5,110

Note: The limit on long-term care insurance premiums is to be applied to ***each*** person claimed on the tax return.

In addition to the limited tax deduction, long-term care insurance premiums must qualify by meeting the following:

1. Provide coverage only for qualified long-term care services;
2. Be guaranteed renewable;
3. Have no cash value; and
4. Use of refunds or dividends only to reduce future premiums or increase future benefits.

Retirement community entrance fee: It has become common for retirement communities to charge a one-time entrance or founder's fee in exchange for the facilities use of accommodations and care for the remainder of one's lifetime.

Unfortunately, the IRS has not provided clear guidance on deducting this fee. In fact, there are court cases that are clear we do not have official guidance. The IRS has stated it has no published position regarding the method of allocating fees between amounts properly deductible and not deductible as medical expenses[7]. However, IRS Revenue Ruling 76-481 states that to the extent the retirement community can document a reasonable estimate of the percentage of its overall operating expenses spent for providing medical care, that percentage can be applied to the one-time and continuing payments to the facility.

Therefore, we believe it is reasonable to take a tax deduction for the percentage of medical care.

Example: Jerry is entering a retirement community that provides accommodations, meals, activities, and lifetime care, including medical care in which he will pay a one-time entrance fee of $40,000. Jerry will also pay a monthly fee of $4,000. The retirement community provides Jerry with documentation that reasonably estimates 40% of its expenses are for medical care to the residents. Therefore, Jerry can take a tax deduction for 40% of the entrance

[7] Ltr. Rul. 8930023 and 8930024

fee ($40,000 X 40% = $16,000) in the year paid. He may also deduct 40% of the monthly fee as a medical expense each year that he pays the fee.

Let's assume Jerry becomes a resident of the retirement community on July 1, 2017. On July 1, Jerry pays the entrance fee of $40,000. Jerry also pays monthly $4,000 from July to December 2017. On Jerry's 2017 tax return, he will be able to take a tax deduction for medical expenses relating to the retirement community in the amount of $25,600.

Calculation = 40% of entrance fee is $16,000 and $4,000 paid for six months is $24,000 of which 40% qualifies as a medical expense deduction which is $9,600 for a total of $25,600.

Part II: Who claims the medical deduction?

Medical expenses are generally deductible by the person actually paying the expenses. These are itemized deductions taken on Schedule A.

As you may not expect, medical expenses can also be deductible by the following:

1. Your children, or
2. Anyone who can claim you as a dependent.

First, if you are the one paying the medical expenses, you are the one who receives the tax deduction. *Medical expenses are always deductible by the person who actually pays them to the medical provider.* Therefore, if adult children are paying the medical expenses of their parents, they should pay directly to the medical provider so that the issue of a gift cannot be confused or interpreted by the IRS.

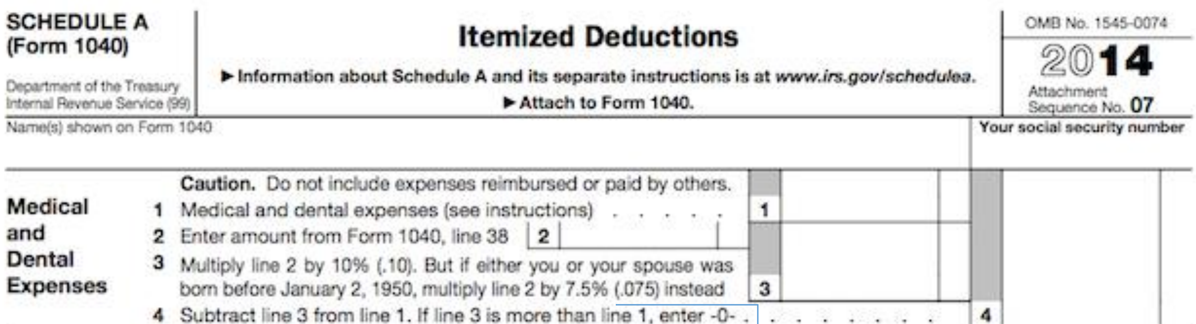
Second, it is common for elderly parents to live with their children. The tax code allows a tax deduction for medical expenses of all dependents claimed on the tax return. Thus, adult children that claim their parents as dependents on their tax return may be able to claim medical expense deduction for medical costs paid.

Part III: How is the medical expense correctly reported on the tax return?

Medical expenses that exceed 10% of your adjusted gross income (AGI) are deductible on Schedule A of Form 1040 for those who itemize their deductions[8]. Medical expenses are not reduced by the itemized deduction phase-out required by IRC Section 68.

__Change Starting in 2017:__ The 10% AGI threshold applies to everybody. Before this year, many people were able to start deducting medical expenses once over 7.5% of AGI.

Below is the top part of Schedule A which is where the medical expense deduction is taken. As you can see, the IRS does not have an updated 2017 Schedule A that subjects everybody to 10% AGI.



SCHEDULE A (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Itemized Deductions

▶ Information about Schedule A and its separate instructions is at *www.irs.gov/schedulea*.

▶ Attach to Form 1040.

OMB No. 1545-0074

2014

Attachment Sequence No. 07

Name(s) shown on Form 1040

Your social security number

Medical and Dental Expenses		**Caution.** Do not include expenses reimbursed or paid by others.		
	1	Medical and dental expenses (see instructions)	1	
	2	Enter amount from Form 1040, line 38 | 2 |		
	3	Multiply line 2 by 10% (.10). But if either you or your spouse was born before January 2, 1950, multiply line 2 by 7.5% (.075) instead	3	
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-		4

7.5% of AGI no longer applicable

Tax Law Change: With the signing of the Tax Cuts and Jobs Act on December 22, 2017, the AGI threshold has been changed to 7.5% for tax years 2017 and 2018. Tax years 2019 and beyond the AGI threshold is 10%. These AGI thresholds applies to everybody. There is no longer a separate threshold for those born before January 2, 1950. This information is pursuant to Section 11027(f)(2) of H.R.1 Tax Cuts and Jobs Act that is an Amendment to the Internal Revenue Code of 1986.

[8] IRC Section 213

Part V: Summary

Now that you are familiar with the types of medical care and expenses that are tax deductible, you can take advantage of potential huge tax savings! If you have questions regarding the deductibility of an expense, we suggest you seek the advice of an IRS Enrolled Agent Tax Practitioner.

You can obtain additional information online at https://www.irs.gov/individuals/seniors-retirees.

IRS Publication 554, Tax Guide for Seniors and Publication 502 Medical and Dental Expenses are also excellent resources.

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__Appendix 1:__ Tax deductible medical expense as listed by the IRS Publication 554, Tax Guide for Seniors.

Table 4-1. **Medical and Dental Expenses Checklist**

You can include:

- Bandages
- Capital expenses for equipment or improvements to your home needed for medical care (see Pub. 502)
- Certain weight-loss expenses for obesity
- Diagnostic devices
- Expenses of an organ donor
- Eye surgery—to promote the correct function of the eye
- Guide dogs or other animals aiding the blind, deaf, and disabled
- Hospital services fees (lab work, therapy, nursing services, surgery, etc.)
- Lead-based paint removal (see Pub. 502)
- Long-term care contracts, qualified (see Pub. 502)
- Meals and lodging provided by a hospital during medical treatment
- Medical and hospital insurance premiums
- Medical services fees (from doctors, dentists, surgeons, specialists, and other medical practitioners)
- Medicare Part D premiums
- Oxygen equipment and oxygen
- Part of life-care fee paid to retirement home designated for medical care
- Prescription medicines (prescribed by a doctor) and insulin
- Psychiatric and psychological treatment
- Social security tax, Medicare tax, FUTA, and state employment tax for worker providing medical care (see Pub. 502)
- Special items (artificial limbs, false teeth, eyeglasses, contact lenses, hearing aids, crutches, wheelchair, etc.)
- Special education for mentally or physically disabled persons (see Pub. 502)
- Stop-smoking programs
- Transportation for needed medical care
- Treatment at a drug or alcohol center (includes meals and lodging provided by the center)
- Wages for nursing services (see Pub. 502)

You can't include:

- Contributions to Archer MSAs (see Pub. 969)
- Bottled water
- Diaper service
- Expenses for your general health (even if following your doctor's advice) such as: —Health club dues —Household help (even if recommended by a doctor) —Social activities, such as dancing or swimming lessons —Trip for general health improvement
- Flexible spending account reimbursements for medical expenses (if contributions were on a pretax basis) (see Pub. 502)
- Funeral, burial, or cremation expenses
- Health savings account payments for medical expenses (see Pub. 502)
- Illegal operation or treatment
- Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc.
- Medical insurance included in a car insurance policy covering all persons injured in or by your car
- Medicine you buy without a prescription
- Nursing care for a healthy baby
- Prescription drugs you brought in (or ordered shipped) from another country, in most cases (see Pub. 502)
- Surgery for purely cosmetic reasons (see Pub. 502)
- Toothpaste, toiletries, cosmetics, etc.
- Teeth whitening
- Weight-loss expenses not for the treatment of obesity or other disease

Appendix 2: Household Employees

As mentioned earlier under the section In Home Medical Care, page 10, if you go the route of staying in your home and having outside assistance help, you may have a household employee. Per IRS, you have a household employee if you have control of what work is done and how it is done. This includes many caretakers, health aides, and private nurses. However, if this person is provided to you through an agency, they are generally not your household employee.

Services of a household nature in or about a private home include services performed by cooks, waiters, butlers, housekeepers, governesses, maids, valets, babysitters, janitors, laundresses, furnacemen, caretakers, handymen, health aides, cleaning people, nannies, gardeners, footmen, grooms, valets, and chauffeurs of automobiles for family use. Services that are not ordinarily a part of household duties and involve the use of skilled or specialized training are not of a household nature even though performed in or about the employer's private home (Rev. Rul. 71-389). Thus services performed by a licensed health care professional, although provided in the home, are not considered to be services provided by household employees.

If you pay more than $2,000 of cash wages to a person that you control what work is done and how it is done you may have a household employee. Thus, you may have to file Schedule H with your tax return and submit payroll taxes with your tax return. You should consult with your tax professional if this applies to your situation.

Appendix 3: Use the worksheet (on the next page) for recording medical expenses throughout the year as discussed on page 11. Then at the end of the year, when you are meeting with your tax professional, this worksheet will have all your out of pocket medical expenses that you paid throughout the year.

Deducting medical expenses on tax returns is a commonly missed deduction because quite simply, out of pocket medical expenses when paid are not kept in an organized fashion.

MEDICAL EXPENSES PAID IN 2017

Medical Care:

Date	Doctor	Location	Miles Driven	Notes/ Comments

Prescriptions:

Date	Pharmacy	Location	Miles Driven	Notes/ Comments

Premiums Paid & Other Medical Expenses:

Date	Where Purchased	Location	Miles Driven	Notes/ Comments