Tax Considerations During a Time of Chronic Illness of a Family Member

37th Annual Federal and State Tax Institutes

December 2, 3 & 4, 2013

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How to File Form 1040

- Married filing joint is generally the most favorable, but
- Married filing separate returns may be beneficial if one spouse has low income and high expenses (e.g. medical) that would otherwise be limited or lost by filing a joint return
- In year of death – surviving spouse can still file a joint return
- In year of death – PA requires separate return filed for decedent

Certain Types of Income

- Social Security benefits – 0%, 50% or 85% can be taxed based on provisional income. Can start collecting a reduced benefit at age 62. SSA planning is beyond the scope of this outline.
- SSI Disability benefits are not taxable
- Long term care reimbursement generally not taxable
- E/EE bonds – in year of death – can elect to pick up all accrued but previously unreported interest on decedent's final 1040

Pension, IRA and 401(k) Distributions

- Required Minimum Distributions (RMD) – must begin at age 70 1/2
- First RMD can be deferred until April 1 of the year following age 70 1/2
- RMD must be taken in year of death by beneficiary(ies) to the extent the decedent did not take full amount (50% PENALTY FOR FAILURE TO TAKE PROPER AMOUNT)
- Taking larger distribution prior to death if income tax will be less than estate/inheritance tax or if tax rate of decedent will be less than beneficiary's rate

Medical Expenses

IMPORTANT: Medical expenses paid directly to the provider are not considered as gifts to the individual and are not counted toward the $14,000 annual gift exclusion or the $5,250,000 lifetime exclusion. These payments can still be deducted by the donee on Schedule A as a medical expense!

Planning for Medical Expenses

- Consider bunching payments to be able to itemize deductions every other year
- Deductible over 7 ½ (10% if under age 65 beginning in 2013) of AGI; 10% for Alternative Minimum Tax purposes
- Percentage of monthly fee paid to assisted living facility is deductible as a medical expense (including entrance fee)
- Most of monthly fee paid for nursing care is deductible
- Portion of long term care insurance is deductible

Planning for Medical Expenses - Continued

- OTC medical purchases only deductible if prescribed by a doctor
- Medical equipment and supplies sold OTC (without a prescription)
- It is illegal to import drugs from another country, so no deduction
- Certain home detachable installations are deductible

Planning for Medical Expenses - Continued

- Certain home improvements – limited to the excess of the actual cost over the increase in FMV of the home; and only if the main purpose of the expense is to provide medical benefits
- Transportation and lodging deduction allowed if accompanying patient, and certain travel by parents to visit their child in a special school for children with drug problems. Personal vehicle use is deductible at 23.5 cents per mile. Also deductible is the extra commuting expenses to take a disabled person to work who cannot drive himself.

Planning for Medical Expenses - Continued

- Some wages and payroll taxes paid to nurses are deductible (may need to issue a W-2 and pay employment taxes). Amounts paid for extra rent or utilities to provide space for nurse is also deductible. Restrictions apply to payments to relatives.
- Certain special education tuition, including meals, lodging and transportation
- Cost of attending medical conference related to the chronic illness of the taxpayer, spouse or dependent can be deducted; but not meals or lodging

Sale of Home

- $250,000 ($500,000 if married filing jointly) exclusion of gain on sale of principal residence if 2 out of 5 year residency requirement is met. Only one spouse has to have owned the house but both must have used it as a primary residence during that period.
- Not disqualified from 2 out of 5 year requirement if moved to a medical facility.
- Surviving spouse may use full $500,000 exclusion if home sold within 2 years of spouse's death and other conditions are met.

Sale of Home – Continued

- Sale within 2 year period – may qualify for a partial exclusion if due to health and the primary reason is (1) to obtain, provide or facilitate the diagnosis, cure, mitigation or treatment of disease, illness or injury of a qualified individual; which includes family members even if they aren't dependents and includes descendants of taxpayer's grandparents. Generally, a health condition treatment is met if a doctor recommends a change of residence for the health reasons listed above. Other reasons for qualifying for a partial exclusion include change of employment or unforeseen circumstances.
- Use of Qualified Personal Residence Trust (QPRT) for larger estates

Other Considerations

- Long Term Care Insurance
- Investments – need to reconsider allocation since income and cash flow will be different during a period of disability (may want to be more conservative and generate more income vs. growth)
- Waiver of Penalties – such as the 10% penalty on premature distributions from an IRA, HSA or MSA account may apply
- Which assets to use first – traditional IRA, Roth accounts, non-qualified brokerage accounts, equity line of credit or cash value of life insurance?

Gifts to Individuals to Reduce Taxable Estate

- $14,000 annual exclusion
- $5,250,000 lifetime exclusion (2013) for regular and generation skipping transfers
- See note above regarding exclusion for medical payment made directly to the provider.

Other Documents and Issues

- Wills need to be updated
- Trusts need to be updated
- Durable Power of Attorney needs to be updated
- Advanced Medical Directives should be updated to include HIPAA provision
- Issues amplified if dealing with same-sex couples
- Beneficiary designations need to be updated
- Creating joint accounts with adult children could ruin a perfectly good estate plan

Questions?

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