

Medical Deductions and Information Booklet



Health Savings Accounts.....	Page 2
Deductible Medical Expenses.....	Pages 3 - 6
Dependents and Medical Expenses.....	Page 7
Eldercare.....	Page 7

Health Savings Accounts Offer Tax Breaks

A Health Savings Account is a trust account where tax-deductible contributions can be made by qualified taxpayers who have high deductible medical insurance plans. Income earned on the HSA balance is income-tax-free. The funds from these accounts are then used to pay “**qualified medical expenses**” not covered by the medical insurance for an “**eligible individual**.” If these funds are not used, they roll over year to year. At age 65, the funds can be used like a retirement plan (taxable when withdrawn, but not subject to a withdrawal penalty) or continue to be saved for future medical expenses. Since the contribution is an above-the-line deduction, a taxpayer need not itemize to take advantage of this new tax break. The rules discussed here are applicable to Federal tax returns and may not apply to your particular state.

- **Eligible Individual** – The new law defines an eligible individual as one who is covered by a “**high deductible plan**” and, while covered by that high deductible plan, is not also covered by another plan that does not have a high deductible. For purposes of determining if there is coverage that does not have a high deductible, the new law allows certain types of coverage such as worker’s compensation, insurance for a specific condition, dental care, vision, long-term care and certain others to be disregarded.
- **High-Deductible Plans** – For 2008, high-deductible plans are defined as those with the following deductible amounts:
 - Self-only coverage with an annual deductible of \$1,100 or more and limits on annual expenses, other than premiums, required to be paid by the plan during the year, up to \$5,600; or
 - Family coverage with an annual deductible of \$2,200 or more and limits on annual expenses, other than premiums, required to be paid by the plan during the year, up to \$11,200.
- **Qualified Medical Expenses** – Qualified medical expenses that can be paid from these accounts are generally defined as those that would be allowable as a medical deduction on your tax return.
- **Contribution Limits** - The eligibility and contribution amounts for these accounts are determined monthly. Therefore, during any month in which you qualify, you would be entitled to contribute 1/12 of the annual limits. For 2008, the annual limits (note these values are adjusted annually for inflation) are the lesser of the policy annual deductible or:
 - \$2,900 for single coverage plans,
 - \$5,800 for family coverage plans, and
 - \$900 additional for individuals age 55 or older.

Individuals entitled to benefits under Medicare and those claimed as a dependent on another person’s tax return cannot make contributions. Contributions can be made as late as the due date of the tax return without extensions, and contributions in excess of the allowable amounts are subject to an annual 6% excise penalty. If your employer makes the contributions for you through a payroll deduction plan, the contributed amounts are not subject to normal payroll withholdings such as FICA and income taxes.

Example: *John, a single taxpayer, age 58, begins a high-deductible health plan with an annual deductible of \$5,000 starting in March of 2008. We need to determine his maximum annual contribution limit, which is the smaller of the deductible amount or \$3,800 (\$2,900 plus \$900 for being over 55). Next, we divide the annual limit by 12 to determine the monthly limit, and in John’s case, it is \$316.67 (\$3,800/12). Since John was in a high-deductible health plan for 10 months during 2008, his contribution limit for 2008 would be \$3,166.70 (\$316.67 x 10). If John were in the 25% tax bracket, John would realize a tax savings of \$792.*

Deductible Medical Expenses

- Acupuncture
- Air Conditioning equipment necessary for relief from allergies or other respiratory ailments
- Alcoholism-related expenses
- Ambulance service
- Artificial limbs and teeth
- Attendant for blind or deaf student
- Braille books/magazines to the extent of their cost over the regular printed editions
- Breast reconstruction after a mastectomy
- Camp tuition for programs designed for children with disabilities
- Capital expenses. Certain modifications to a primary home*
- Cars. The cost to modify a vehicle for use by a disabled person
- Childbirth preparation classes
- Chiropractic car
- Contact lenses
- Contraception prescribed by a doctor
- Cosmetic surgery to improve a deformity related to a congenital abnormality, accident or disease
- Crutches
- Dentures
- Diagnostic fees
- Doctors and physicians
- Drug addiction treatment
- Dyslexia language training
- Exercise programs recommended by a doctor as treatment for a specific condition, NOT for overall health
- Eyeglasses
- Eye surgery (LASIK)
- Fertility enhancement
- Guide dog
- Hearing aids and batteries
- Hospital care
- Insurance premiums*
- Laboratory fees
- Legal fees paid to authorize treatment for mental illness
- Long-term care insurance and expenses subject to certain limitations*
- Mattresses and boards bought specifically to alleviate an arthritic condition
- Medical aids
- Medical conferences
- Medicine and drugs prescribed by a doctor
- Medical equipment and supplies
- Nursing Care
- Nursing home
- Orthopedic shoes to the extent of their cost over regular shoes
- Oxygen and oxygen equipment
- Prosthetics
- Smoking cessation programs
- Special Education. Tuition for sending a mentally impaired or physically disabled person to a school with the resources to relieve the effects of the disability.
- Sterilization and legal pregnancy termination
- Swimming. Therapeutic swimming costs if recommended by a doctor
- Telecom equipment required for hearing-impaired persons
- Transplants
- Travel and transportation related to medical need*
- Vasectomy
- Visual alert system
- Weight loss programs as prescribed by a doctor
- Wheelchairs and motorized scooters
- X-ray Services

Capital Expenses

Amounts paid for special equipment installed in the home or for improvements may be included in medical expenses, if their main purpose is medical care for the taxpayer, the spouse, or a dependent. The cost of permanent improvements that increase the value of the property may be partly included as a medical expense. The cost of the improvement is reduced by the increase in the value of the property. The difference is a medical expense. If the value of the property is not increased by the improvement, the entire cost is included as a medical expense.

Certain improvements made to accommodate a home do not usually increase the value of the home and the cost can be included in full as medical expenses. These improvements include, but are not limited to, the following items:

- Constructing entrance or exit ramps for the home,
- Widening doorways at entrances or exits to the home,
- Widening or otherwise modifying hallways and interior doorways,
- Installing railings, support bars, or other modifications,
- Lowering or modifying kitchen cabinets and equipment,
- Installing porch lifts and other forms of lifts but generally not elevators,
- Modifying fire alarms, smoke detectors, and other warning systems,
- Modifying stairways,
- Adding handrails or grab bars anywhere (whether or not in bathrooms),
- Modifying hardware on doors,
- Modifying areas in front of entrance and exit doorways, and
- Grading the ground to provide access to the residence.

Only reasonable costs to accommodate a home to a disabled condition are considered medical care. Additional costs for personal motives, such as for architectural or aesthetic reasons, are not medical expenses.

Insurance Premiums

You can include in medical expenses insurance premiums you pay for policies that cover medical care. Policies can provide payment for:

- Hospitalization, surgical fees, x-rays, etc.,
- Prescription drugs,
- Membership in an association that gives cooperative or so-called "free-choice" medical service or group hospitalization and clinical care, and
- Qualified long-term care insurance contracts (subject to additional limitations).

Pre-tax dollars - You cannot deduct insurance premiums paid with pre-tax dollars because the premiums are not included in your wages. If you have a policy that provides more than one kind of payment, you can include the premiums for the medical care part of the policy.

Employer-sponsored health insurance plan - Do not include in your medical any insurance premiums paid by your employer-sponsored health insurance plan, unless the premiums are included in your wages.

Medicare B - Medicare B is a supplemental medical insurance. Premiums you pay for Medicare B are a deductible medical expense.

Prepaid insurance premiums - Premiums you pay before you are age 65, for insurance for medical care for yourself, your spouse, or your dependents after you reach age 65, are medical care expenses in the year paid, if they are payable in equal yearly installments, or more often, and payable for at least 10 years, or until you reach age 65 (but not for less than 5 years).

You cannot include premiums you pay for:

- Life insurance policies,
- Policies providing payment for loss of earnings,
- Policies for loss of life, limb, sight, etc.
- Policies that pay you a guaranteed amount each week for a stated number of weeks if you are hospitalized for sickness or injury, or
- The part of your car insurance premiums that provides medical insurance coverage for all persons injured in or by your car because the part of the premium for you, your spouse, and your dependents is not stated separately from the part of the premium for medical care of others.

Long-Term Care

Amounts paid for long-term care services and certain premiums paid on long-term care insurance are deductible as medical expenses. Costs of care provided by a relative who is not a licensed professional or by a related corporation or partnership don't qualify. The maximum amount of long-term care premiums treated as medical depends on the insured's age and is inflation-indexed annually. The following are the deductible amounts for 2008:

Age	2008
40 or less	310
41 to 50	580
51 to 60	1,150
61 to 70	3,080
71 & older	3,850
Per Diem	270

The "**Long-term contract**" is an insurance contract that provides only coverage of long-term care and meets certain other requirements. Some long-term care riders to life insurance will also qualify. Benefits under a long-term care policy are generally tax-free. For per-diem contracts that pay a flat-rate benefit without regard to actual long-term care expenses incurred, the inflation adjusted exclusion is limited to \$270 a day (2008), except when long-term care costs incurred are more than the flat rate and are not otherwise compensated by some other means.

A contract isn't treated as a qualified long-term care contract unless the determination of being chronically ill takes into account at least five activities of daily living-eating, toileting, transferring, bathing, dressing and continence.

"Long-term care services" include necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, maintenance or personal care services prescribed by a licensed practitioner for the chronically ill.

A "**Chronically ill person**" is one who has been certified by a licensed healthcare practitioner within the previous 12 months as: (1) unable to perform at least two activities of daily living (eating, toileting, transferring, bathing, dressing, continence) without substantial assistance for a period of 90 days due to loss of functional capacity, (2) having a similar level of disability as determined in regulations, or (3) requiring substantial supervision to protect from threats to health and safety due to severe cognitive impairment. The requirement that a qualified long-term care insurance contract must base its determination of whether an individual is chronically ill by taking into account five activities of daily living applies only to (1) above (being unable to perform at least two activities of daily living).

Medical Travel Expenses

Auto Travel - Deduction is allowed at a specified cents per mile rate (see table) or for actual cost of gas and oil (not repairs, maintenance, depreciation, lease fees, etc.)

Year	2008
Rate	19.0

Trips - Amounts paid for transportation to another city may be included in medical expenses, if the trip is primarily for, and essential to, receiving medical services. Up to \$50 per night for lodging may be included. A trip or vacation taken merely for a change in environment, improvement of morale, or general improvement of health cannot be included in medical expenses, even if the trip is made on the advice of a doctor.

Lodging - The cost of meals and lodging at a hospital or similar institution may be included if the main reason for being there is to receive medical care. Medical expenses may also include the cost of lodging not provided in a hospital or similar institution. The cost of such lodging while away from home may be included if all of the following requirements are met:

1. The lodging is primarily for and essential to medical care.
2. The medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital.
3. The lodging is not lavish or extravagant under the circumstances.
4. There is no significant element of personal pleasure, recreation, or vacation in the travel away from home. The amount included in medical expenses for lodging cannot be more than \$50 for each night for each person. Lodging is included for a person for whom transportation expenses are a medical expense, because that person is traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to \$100 per night is included as a medical expense for lodging. Meals are not deductible.

Meals - Meals are generally not deductible as a medical expense except as part of inpatient care. As such, they would be included in the cost of the hospital or other medical facility.

Dependents & Medical Expenses

Medical Dependents - Medical expenses paid for dependents may be deducted. To claim these expenses, the person must have been a dependent either at the time the medical services were provided, or at the time the expenses were paid. A person generally qualifies as a medical dependent for purposes of the medical expense deduction if:

1. That person lived with the taxpayer for the entire year as a member of the household or is related,
2. That person was a U.S. citizen or resident, or a resident of Canada or Mexico for some part of the calendar year in which the tax year began, and
3. The taxpayer provided over half of that person's total support for the calendar year. Medical expenses of any person who is a dependent may be included, even if an exemption for him or her cannot be claimed on the return.

Child of Divorced or Separated Parents - If either parent can claim a child as a dependent under the rules for divorced or separated parents, each parent can include the medical expenses he or she pays for the child. This is true even if the other parent claims the exemption for the child.

Support Claimed Under a Multiple Support Agreement - A multiple support agreement is used when two or more people provide more than half of a person's support, but no one alone provides more than half. Whoever is considered to have provided more than half of a person's support under such an agreement can deduct medical expenses paid.

Any medical expenses paid by others who joined in the agreement cannot be included as medical expenses by anyone.

Eldercare Can Be a Medical Deduction

With people living longer, many find themselves becoming the care provider for elderly parents, spouses and others who can no longer live independently.

Generally, the entire cost of nursing homes, homes for the aged, and assisted living facilities are deductible as a medical expense, if the primary reason for the individual being there is for medical care or the individual is incapable of self-care. This includes the entire cost of meals and lodging at the facility. If the individual is in the facility primarily for personal reasons, only expenses directly related to medical care are deductible and the meals and lodging would not be a deductible medical expense.

As an alternative to nursing homes, many care providers are hiring day help or live-in employees to provide care at home. When this is the case, the services provided by the employees must be allocated between household chores and deductible nursing services. To be deductible, the nursing services need not be provided by a nurse as long as the services provided are the same, such as administering medication, bathing, feeding, dressing, etc. If the employee also provides general housekeeping services, the portion of employee's pay attributable to household chores is not a deductible medical expense.

Household employees are subject to Social Security and Medicare taxes, and it is the responsibility of the employer to withhold the employee's share of these taxes and to pay the employer's payroll taxes. Special rules for household employees greatly simplify these payroll withholding and reporting requirements and allow the Federal payroll taxes to be paid annually in conjunction with the employer's individual 1040 tax return. Federal income tax withholding is not required unless both the employer and the employee agree to withhold income tax. However, the employer is still required to issue a W-2 to the employee and file the form with the Federal government. A Federal Employer ID Number and a state ID number must be obtained for reporting purposes. Most states have special provisions for reporting and paying state payroll taxes on an annual basis that are similar to the Federal reporting requirements.

If you need assistance in setting up a household payroll, please contact this office for additional details and filing requirements.