Tax Aspects of Medical Care Costs in Late Life and in Settling Decedents' Affairs

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Deductions for personal living expenses are generally prohibited under the Internal Revenue Code. Legislation in 1942 carved out an exception, allowing an individual to deduct medical care expenses "not compensated by insurance or otherwise". The deduction has been part of the Code ever since, despite its initial purpose as a wartime relief measure.

But for the entire time, the total amount of such expenses in a given year has been subject to reduction by a "floor" – a specific percentage of adjusted gross income – so that only the excess of that total amount over the floor is actually deductible. And even in a year when a taxpayer's total medical expenses exceed the floor, they produce no tax benefit unless the sum of that deduction amount plus all other allowable personal deductions (taxes, interest, etc.) exceeds the applicable standard deduction.

As a result, young healthy people, particularly those who have decent insurance, rarely have sufficient uncovered medical expenses to provide any actual income tax benefit. So when the question of medical expenses arises during the yearly tax data gathering for such an individual, the answer is usually "don't bother".

Later in life, particularly after an individual retires and adjusted gross income (and thus the medical deduction floor) generally decreases, uninsured or otherwise uncompensated medical care costs more often are worth tracking. Additionally, when such costs remain unpaid at the time of an individual's death, a special choice of tax regime (income tax or estate tax) applies. Thus, every attorney whose practice includes elder law, probate or both, and every accountant or financial advisor who assists elderly clients with tax matters, should have a good grasp of the enduring tax principles associated with medical care. This material is an attempt to highlight the principles generally most important for this age group, and also to provide starting points for further research when the matter at hand requires it.

I. Overview

A. What constitutes medical care for income tax purposes

1. How is medical care defined in the Internal Revenue Code for purposes of the income tax deduction?

Medical care for purposes of the IRC § 213(a) income tax deduction is defined in IRC § 213(d)(1) to include amounts paid for

(i) the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body [this two-prong definition was included in the original statute and is essentially unchanged since],
(ii) transportation primarily for and essential to the above,
(iii) qualified long-term care services as defined in IRC § 7702B(c), and
(iv) insurance (including Medicare) that covers costs of care included in the above and for any qualified long-term care insurance contract as defined in IRC § 7702B(b), but limited to certain total annual amounts based on age as set forth in IRC § 213(d)(10)

Because the deduction was enacted as, and continues to be, an exception to the general prohibition on deducting personal living expenses, deductibility of costs under IRC § 213 must be construed narrowly. *H. Grant Atkinson, Jr. v. Commissioner*, 44 TC 39, 49 (1965). [*See* I.B.1. below for further discussion of criteria developed to distinguish deductible from nondeductible costs in the context of expenditures to promote general health.]

2. Are costs to prevent, diagnose or treat mental illness and cognitive deficits or decline also included?

Yes. Amounts paid with respect to diseases and impairments of the mind (as opposed to those of the body) have been treated as paid for medical care from the outset, but at first solely because that intent was made plain in the legislative history. The inclusion of mental disorders as diseases in the Regulations occurs at Treas. Reg. § 1.213-1(e)(1)(ii).

"Given the reference to 'mental defect' in the legislative history and the regulations, it has also long been settled that 'disease' as used in section 213 can extend to mental disorders. See, e.g., *Fischer v. Commissioner*, 50 T.C. 164, 173 n.4 (1968) ('That mental disorders can be '"disease" within the meaning of [section 213(d)(1)(A)] is no longer open to question.'); *Starrett v. Commissioner*, 41 T.C. 877 (1964); *Hendrick v. Commissioner*, 35 T.C. 1223 (1961)." *Rhiannon G. O'Donnabhain v. Commissioner*, 134 TC 34, 50 (2010), *acq*. AOD 2011-003.

3. Can charges of parties other than medical care providers also be deducted if directly related to obtaining care?

Possibly. Where non-medical costs would not have been incurred but for the need to incur medical costs – especially legal fees involved in commitment or compulsory confinement for mental disorders – those costs are also deductible. *Gertsacker v. Commissioner*, 24 AFTR 2d 69-5389, 69-5391 (CA6, 1969).

Fifty years ago, a deduction was allowed for subscription fees paid to a computer data bank where a taxpayer's medical history was stored and made available to physicians and other care providers. The service was seen as facilitating diagnosis and thus helping to prevent or alleviate illness. Rev. Rul. 71-282, 1971-2 CB 166. Charges today for cloud storage counterparts of this service may not be exceptionally large, but they should be considered where the but-for test may be satisfied.

4. Must treatments, drugs or equipment be provided, or ordered or even recommended, by a licensed health care practitioner for the costs to be deductible?

For costs of drugs, there is indeed such a requirement, discussed at II.A.2.b. below. Equipment such as a walker, and supplies such as blood sugar testing kits, however, need not be prescribed for their costs to be deductible. Rev. Rul. 2003-58, 2003-1CB 959. Similarly, there is no explicit requirement that a service or treatment that is therapeutic for the particular individual be provided by a licensed practitioner. The focus is on whether the service itself, not the provider, is within the definition of medical care. Rev. Rul. 63-91, 1963-1 CB 54; *C. Fink Fischer v. Commissioner*, 50 TC 164, 174-75 (1968). Note, however, that with unorthodox treatments there must be some medical support for the treatment at issue, and the taxpayer must have a reasonable expectation that it will be effective. *David F. Tautolo*, TC Memo 1975-277, 75-1172-73.

The recommendation of a practitioner can be important because it suggests that an outlay is not a personal expenditure, but outlays for items that are wholly medical in nature, and that cannot serve any other function in everyday life, are deductible even in the absence of such a recommendation. Rev. Rul. 2007-72, 2007-2 CB 1154.

Example: A taxpayer who has concerns about a possible ailment and undergoes expensive testing such as a CT scan, even where no physician recommended it, will have a deductible cost for whatever insurance doesn't cover.

B. When expenditures that may provide health benefits are *not* medical care for income tax purposes

1. If amounts paid for the prevention of disease are deductible, does that include amounts paid to maintain general health or well-being?

Generally, no. An "expenditure which is merely beneficial to the general health of an individual, such as an expenditure for a vacation, is not an expenditure for medical care." Treas. Reg. § 1.213-1(e)(1)(ii). An indirect health benefit from an expenditure that isn't *incurred primarily for a medical purpose* will not support a deduction.

"In *Jacobs v. Commissioner*, 62 T.C. 813 (1974), this Court reviewed the legislative history of section 213 and synthesized the caselaw to arrive at a framework for analysis of disputes concerning medical expense deductions. Noting that the medical expense deduction essentially carves a limited exception out of the general rule of section 262 that 'personal, living, or family expenses' are not deductible, the Court observed that a taxpayer seeking a deduction under section 213 must show: (1) 'the present existence or imminent probability of a disease, defect or illness—mental or physical' and (2) a payment 'for goods or services directly or proximately related to the diagnosis, cure, mitigation, treatment, or prevention of the disease or illness.' *Id*. at 818. Moreover, where the expenditures are arguably not "wholly medical in nature" and may serve a personal as well as medical purpose, they must also pass a 'but for' test: the taxpayer must 'prove both that the expenditures were an essential element of the treatment and that they would not have otherwise been incurred for nonmedical reasons.' *Id*. at 819." *O'Donnabhain*, 134 TC at 50.

Example: Concerned that, as he grows older, his overall good health may begin to fail, a taxpayer enrolls in a local health club so that he can do daily workouts. The health club charges are not deductible because the taxpayer's use of the club isn't part of a regimen to prevent or treat a particular ailment.
Variation: If the taxpayer was diagnosed by a physician as clinically obese, and directed to enroll in a weight loss program that was monitored by the physician, the initiation fee and any periodic fees for the program would be deductible. Rev. Rul. 2002-19, 2002-1 CB 779.

2. If medical services or care are allowable under the law of the locality where provided, does it matter whether they might be in violation of federal law?

It does matter. Payments for operations, drugs or treatments that are illegal under federal law aren't deductible even if allowable under the local law of a taxpayer's domicile. Treas. Reg § 1.213-1(e)(1)(ii); Rev. Rul. 97-9, 1997-1 CB 77.

The Revenue Ruling cited immediately above addressed this principle for what has become much more common since – marihuana and cannabis products. Whether or not prescribed by a physician and regardless of the intended health benefit, no medical deduction for such costs is allowable.

The costs of prescription drugs that are illegally procured, *e.g.*, purchased in another country where they are cheaper, are not deductible, even if the drugs are identical to those available in the U.S. Treas. Reg. § 1.213-1(e)(2). The Food and Drug Administration offers some information on its website about what drugs, and in what amount, may be legally imported, but that information may not be current. The page about personal importation, for instance, at https://www.fda.gov/industry/import-basics/personal-importation
when accessed on January 6, 2021, said that it was current as of November 10, 2020.

3. When procedures are treated as cosmetic surgery, and under what circumstances are charges for such procedures deductible?

Costs of cosmetic surgery are nondeductible unless incurred to ameliorate a deformity or disfiguring injury. For this purpose, cosmetic surgery is any procedure intended to improve the patient's appearance and that doesn't meaningfully promote the proper function of the body or prevent or treat illness or disease. IRC § 213(d)(9).

Note, however, that reconstructive surgery following a removal of a malignancy, or to correct a deformity that resulted from some other surgical procedure, is not cosmetic surgery. Rev. Rul. 2003-57, 2003-1 CB 959. Indeed, disfigurement that impairs social functioning because it can be stigmatizing may be sufficient premise for a corrective measure to be treated as a medical expense. In one ruling, the cost of a wig, for a taxpayer's dependent daughter who had lost her hair due to disease, was allowed as a deduction, because her doctor recommended it as essential for her mental health. Rev. Rul. 62-189, 1962-2 CB 88.

4. Are there any prohibitions on extravagant or unnecessary expenditures for care?

No. A taxpayer's choice of provider for any type of medical care, and whether that provider's charges may or may not be more than those of other providers of the same care, are generally not challenged. The question may be asked, when the medical care involves travel and lodging costs because the provider is some distance from the individual's tax home, whether those ancillary costs are incurred primarily for and are essential to receiving the care. But that will not affect the deductibility of the cost of the medical care itself.

"… we do not share respondent's concern that our construction will open the door to trips to obtain medical treatment by roundabout routes with stopovers at resort facilities. We are not bereft of talent to deal with such situations as they arise and to sift out those expenses which are not *required to bring the patient to the place of medication*." [emphasis in opinion] *Morris C. Montgomery v. Commissioner*, 51 TC 410, 414 (1968).

What a taxpayer is willing to pay for a medical service reflects an individual perception of value and a personal relationship involving trust in the provider. Thus, the selection of provider is not generally questioned. And as noted above, an individual's concern about a possible malady that prompts what are perhaps unnecessary tests or examinations (even if others might call that concern hypochondria) will not affect the character of the medical services themselves. If they are "diagnosis" within the meaning of IRC § 213(d)(1)(A), their costs should be deductible.

C. Who claims the deduction?

1. What happens if an individual's medical care costs are borne by his or her child or another relative?

In some circumstances, the person who made the payment – not the person who received the care – may be the one who claims the deduction. The deduction is allowed for costs of medical care for the taxpayer, the taxpayer's spouse (if filing a joint return) and the taxpayer's dependents. So if an elderly person can be claimed as a dependent of another person (*e.g.*, his or her child), then that other person can claim the elder's medical care costs, or the elder can do so.

Additionally, if the medical expenses are those of an individual who *would be the taxpayer's dependent but for the gross income test (below)*, the deduction may be claimed by the person who would claim the dependency exemption if the gross income test were also met. IRC § 213(a); Treas. Reg. § 1.213-1(a)(3)(i).

Comment: Even though the personal exemption amount allowed as a deduction for a taxpayer, and, if applicable, for a spouse and for dependents, is currently zero (IRC § 151(d)(5), effective until tax years beginning in 2026), the ability to claim an individual as one's dependent is associated with a number of other tax benefits. One such benefit is the ability to claim medical care deductions for costs of the care of a dependent.

The requirements for claiming an individual as one's dependent are less than straightforward. A full analysis will not be offered here. In general, however, an elderly person can be a dependent of a taxpayer who is that person's child, sibling, or other family member if the elderly person is a

"qualifying relative" of the taxpayer under IRC § 152(d). To be a qualifying relative of another taxpayer for a particular tax year, an elderly person must:
(i) Be one of certain specified relatives of the taxpayer (parents, other ancestors, and siblings among them), or, if unrelated, be a member of the taxpayer's household;
(ii) Have gross income that is less than the exemption amount as defined in IRC § 151(d) and ignoring the 2018-2025 reduction to zero (for 2020, this is $4,300, Rev. Proc. 2019-44, 2019-47 IRB 1093);
(iii) Have more than half of his or her support (as defined) provided by the taxpayer; and
(iv) Under IRC § 152(b)(3), be a citizen or national of the United States, or a resident of the United States, Canada or Mexico.

An elderly person who has only modest gross income, such as Social Security or a small amount of interest income, may be receiving more than half of his or her support (which includes a portion of the value of the shared home, or cost of another residence such as a nursing home, meals, and utilities) from that child. If the relationship, support and citizenship/residence tests are satisfied, the child can claim deductions for the parent's medical care costs regardless of whether the parent's gross income would prevent the child from claiming the exemption.

COMMENT: The prospect of using the medical care costs of an elderly parent on a child's income tax return suggests a planning point for advisers other than elder law or probate attorneys. Any adviser to a younger client who supports a parent should explore whether the client may be able to deduct the parent's uncovered medical care costs in addition to his or her own.

2. When the medical care costs of an elderly person are paid by someone else, such as a child of that person, is that a gift-taxable transfer?

Not if payments are made by the donor directly to the medical care providers. However, there will be a taxable gift (before considering any annual exclusion that's available) when the donor reimburses the donee for the donee's payments.

There's normally no legal obligation to support a parent or other adult relative. Transfers to someone that the transferor is not legally obligated to support - such as a child reimbursing a parent for the parent's payment of his or her medical bills - can be treated as gifts. *Alice H. Lester v. Commissioner*, 41 BTA 515, 522-23 (1940). Treas. Reg § 25.2511-1(h)(3). This would be so even if, for income tax purposes, the child could claim the payment as a deductible medical care cost because the parent was a dependent of the child.

Direct payments to medical care providers for the charges incurred by a third party, by contrast, qualify for an exclusion (with no dollar limitation) from the gift tax regime. IRC § 2503(e)(2)(B); Rev. Rul. 82-98, 1982-1 CB 141.

Example: A taxpayer maintains a home where she lives with her elderly father. She is able to claim her father as her dependent for income tax purposes. On his behalf, she pays the charges of an audiologist who examined her father and the cost of hearing aids recommended by this practitioner. She will be able to claim these payments as a medical care deduction on her income

tax return for the year in which they are paid, but, because the payments were made directly to providers, they will not be treated as taxable gifts.
Variation: If the taxpayer can't claim her father as a dependent, because he contributes more than half of his own support costs, her payments for the audiologist charges and for the hearing aids would still not be treated as taxable gifts, but her father could claim the costs as medical care deductions on his own income tax return. *Cf.* SCA 200225030 (analogous treatment of payment of a taxpayer's deductible taxes by a third party).

D. Substantiation, recordkeeping and maximizing tax benefits

1. What constitutes sufficient proof that an outlay is a deductible medical care expense?

Examinations of individual income tax returns are few and far between, but not unheard of. When they occur, taxpayers and their representatives must be mindful that all deductions from gross income are a matter of legislative grace, allowable only upon demonstration of compliance with the statutes that authorize such deductions. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). Demonstration of compliance must be done pursuant to substantiation requirements in the Code, Regulations and other guidance. Unfortunately, the physical challenges of late life, even without any loss of mental acuity, may cause elderly clients to be less attentive to the recordkeeping needed to support medical care deductions, just at the time when those deductions may have some real tax-saving value.

When requested by the IRS, medical expenses claimed as a deduction must be substantiated. Not surprisingly, the basic items required in each case are the name and address of the payee, an itemized invoice showing the nature of the services rendered, date and amount, but they can also include "…such other information as the district director may deem necessary." Treas. Reg. § 1.213-1(h). If deductions are challenged, the taxpayer has the additional burden of proving the amounts claimed were not compensated by insurance or otherwise. *Goodman v. Commissioner*, 42 AFTR 1019, 1020 (CA2, 1953); *Eva D. Gardner*, TC Memo 1983-541, 83-2199.

2. Is there any other way to establish that expenses for medical care were incurred if documentation is incomplete?

There is a "Hail Mary" approach using surrounding circumstances to estimate costs. The *Cohan* rule has been applied to claims of medical deductions when substantiation fell short. Where there is sufficient evidence to satisfy a court that some amount of deductible outlay was sustained by a taxpayer, the court may make a reasonable estimate of the deduction.

"The Board [of Tax Appeals] refused to allow him [George M. Cohan] any part of this, on the ground that it was impossible to tell how much he had in fact spent [on business-related travel and entertainment], in the absence of any items or details. The question is how far this refusal is justified, in view of the finding that he had spent much and that the sums were allowable expenses. Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making. But to allow nothing at all appears to us inconsistent with saying that something was spent. True, we do not know how many trips Cohan

made, nor how large his entertainments were; yet there was obviously some basis for computation, if necessary by drawing upon the Board's personal estimates of the minimum of such expenses. The amount may be trivial and unsatisfactory, but there was basis for some allowance, and it was wrong to refuse any, even though it were the traveling expenses of a single trip. It is not fatal that the result will inevitably be speculative; many important decisions must be such. We think that the Board was in error as to this and must reconsider the evidence."
Cohan v. Commissioner, 8 AFTR 10552, 10555-56 (CA2, 1930).

Being able to convince a court that a taxpayer suffered for a protracted period from an ailment or infirmity that normally required outlays for treatments or medication, or that a certain hospitalization occurred, may be sufficient to prompt the court to estimate such outlays in the absence of proof. See, e.g., *Michael R. Friend*, TC Memo 1990-144, 90-633; *Randolph Kelly, Jr.*, TC Memo 1983-156, 83-592.

Comment: Nearly all authority for the use of the *Cohan* rule to allow an estimate of medical expenses is found in Tax Court Memorandum decisions. The cases have little factual similarity, but the individual taxpayer's credibility before the court, and the reasons for incomplete documentation, are, unsurprisingly, important in each. A reasonable, good faith effort to approximate expenses when records are unavailable may salvage a deduction that would otherwise be lost, but clients should be advised not to expect that indirect evidence will be given any weight. Estimating expenses should be a when-all-else-fails approach.

3. What sorts of smaller medical care expenditures should clients be urged to capture in their recordkeeping, and when is it worth the trouble?

Clearly, this is a cost-benefit question. Before suggesting what a client will likely see as a burdensome, time-consuming task, one should confirm that, for the particular tax year, enough larger deductible medical care costs have been identified to produce actual tax benefit. Then, hopefully, some smaller expenditures that have been overlooked will be easy to document, with credit card statements, pharmacy records, etc., as "icing on the cake".

Example: A taxpayer makes a weekly trip to a clinic for a blood test; the trip requires driving ten miles each way. For an entire year, that would be 1,040 miles for which a medical care mileage deduction is available. In 2020, at 17 cents per mile (Notice 2020-5, 2020-4 IRB 380), that would only be $177, but likely there would be more driving to other medical appointments or to obtain prescription drugs, and perhaps parking charges as well.

4. Is it permissible to delay payment of one year's medical care charges so that they can be bunched together with the next year's charges, so that the aggregate will exceed the AGI "floor"?

Yes. As noted above, unreimbursed medical care costs will not necessarily produce actual tax benefit, if in a particular tax year, either: (i) the aggregate amount is less than the AGI-based "floor" provided in IRC § 213(a); (ii) total itemized deductions in that year are less than the applicable standard deduction; or (iii) both. Because nearly all individual taxpayers use the cash receipts and disbursements method of accounting, bunching payments for two years' charges (or more) in one tax year, to obtain some tax benefit from the costs, is indeed permissible. Where practical, bunching medical appointments or elective treatments, bulk purchases of prescription drugs, etc. may avoid (nondeductible) finance charges that would be incurred for late payments. Bunching payments, or services and drug purchases, or both, may be a challenge for elderly clients in poor health or for those with more modest incomes. But the strategy should at very least be discussed.

Note, however, that a prepayment for services to be rendered in a future year, *e.g.*, for an elective procedure scheduled far in advance, generally is not deductible in any year before the year in which the services are rendered. *Robert S. Bassett v. Commissioner*, 26 TC 619, 621 (1956).

II. Potentially deductible medical care expenses most common in late life

A. Costs other than personal services or institution charges

1. How are modifications, fixtures and adaptive personal property for homes and vehicles treated?

a. Expenditures for items that are separable from property that they modify

Items that are capital expenditures but are nonetheless incurred only for a medical need, and that are *not permanent improvements* to property are deductible. Treas. Reg. § 1.213-1(e)(1)(iii); Rev. Rul. 70-606, 1970-2 C.B. 66.

Example: Taxpayer who is confined to a wheelchair purchases a van that includes additional-cost equipment to accommodate the wheelchair. The van will only be used for the taxpayer's personal purposes, so its sticker price without considering the special equipment is nondeductible. The equipment is detachable, albeit at some cost, and it doesn't add to the resale value of the van. Thus, the entire additional amount paid for the equipment is a deductible medical care expense.

b. Expenditures for permanent improvements to property

Costs that are incurred for a medical need but that also result in *permanent improvements* to property are *deductible to the extent that the costs don't add value to the property*. Treas. Reg. § 1.213-1(e)(1)(iii). An example of such an improvement is an elevator installed in a home to accommodate a resident who can't climb stairs because of a heart condition. Another is widening doorways. *Id.* Similarly, maintenance costs for capital items installed primarily for a medical need (such as repairs for the elevator above) are deductible. *Id.*

But note that, whether the cost of an item increases the home value or not, if the item isn't medically necessary (e.g. decorative elements in a home modification) the cost isn't deductible. Treas. Reg. § 1.213-1(e)(1)(iii).

c. Expenditures to modify rented property

The costs of permanent improvements to a rented property, if borne by the tenant and incurred primarily for a medical need, can be deducted by the tenant. Rev. Rul. 70-395, 1970-2 CB 65.

Example: A taxpayer who has a heart condition and severe arthritis resides in a house that he rents. His infirmities make it impossible for him to get in and out of the bathtub in the house's only bathroom. At his own expense, because the landlord refuses to pay for any part of the cost, the taxpayer installs a shower with grab bars and a seat in another part of the house. Because the costs of the shower were incurred principally for a medical need, and no addition to the home value (if there is any) inures to the taxpayer, the cost of the shower is a deductible medical expense for the taxpayer.

d. Treatment of payments for improvements when the payments are made over two or more years

If costs for construction of improvements (or elements of a new home) that are incurred primarily for a medical need are paid over two or more tax years, the entire amount attributable to such improvements or elements becomes deductible in the year when they can be first be used for the medical purpose. *Zipkin v. U.S.*, 86-AFTR 2d 2000-7052, 2000-7053 (DC MN, 2000). Essentially, such costs are prepayments that would be recoverable (and therefore not deductible) until the other party to the contract (*e.g.*, the home builder) fully performs. Only at the point when the improvement or new feature is fully complete and ready for use, and the costs are no longer recoverable, can they be deducted. *Id.*

2. What other significant costs become more common in late life?

a. Adaptive equipment

The costs for many types of personal property are almost always incurred primarily for a medical need and should meet the but-for test of *Jacobs*, above. Wheelchairs, walkers or mobility scooters, hearing aids, orthopedic shoes (just the costs in excess of normal shoes), and special telephone equipment for hearing impairments are a few examples. Likewise, the costs of repairs and maintenance of such equipment are deductible as costs of medical care. *See, e.g.*, Rev. Rul. 71-48, 1971-1 CB 99; Rev. Rul. 73-53, 1973-1 CB 139.

b. Prescription drugs

Costs of drugs or biologicals must be intended for use by individuals (not for other animals) and prescribed by a licensed physician to be deductible. IRC §§ 213(b) and 213(d)(3). Note that only drugs and biologicals that cannot be obtained without a prescription qualify; over-the-counter compounds do not, even if recommended by a physician. Rev. Rul. 2003-58, 2003-1 CB 959. A physician for this purpose includes a practitioner within the Social Security Act definition of the term, at 42 USC § 1395x(r). That includes doctors of medicine, osteopathy, dental surgery, dental medicine, podiatry, optometry and chiropractors, who are licensed by a state. *Id.*

Example: A taxpayer incurs costs not covered by insurance for acupuncture treatments intended to relieve neck and back pain in 2020. The costs of these treatments, which were intended to affect a function of the body, are deductible costs of medical care. Rev. Rul. 72-593, 1972-2 CB 180. As an enhancement of the treatments, the acupuncturist, who has no medical license, also prescribes certain naturopathic compounds that are believed to promote muscle relaxation. The costs that the taxpayer incurs for these compounds are not deductible costs of medical care because they are not prescribed by a licensed physician.

B. Charges of hospitals, nursing homes, senior communities or other institutions that provide some element of personal care

1. How are lifetime care communities' charges treated?

One of the common models for senior living is a lifetime care community. Normally, such a community charges both a one-time entrance fee and monthly fees for its promise to provide a continuum of housing and medical services, from independent living through nursing facilities. To the extent a lifetime care community can support 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 Rev. Rul. 76-481, 1976-2 CB 82. Note, however, that this treatment applies only in the context of a lifetime care contract. Otherwise, payments for future care or future medical insurance coverage generally are not deductible. Rev. Rul. 93-72, 1993-2 CB 77.

In many cases, one should ask whether allocation of a community's charges to long-term care services (a broader concept, though it has elements that also fit within the definition of medical care) will add to the deductible portion. The specific requirements for services to be treated as long-term care services are discussed below.

CAUTION: Where a portion or all of a substantial one-time entrance fee is refundable, to that extent it may be a below-market loan requiring the taxpayer to recognize imputed interest income. IRC § 7872(c)(1)(F). But if the portion of an entrance fee that constitutes a loan is made under a qualified continuing care contract (broadly, a lifetime contract for continuum-of-care services and accommodations, from independent living units through nursing facilities) to a qualified continuing care facility, an exception applies. Indeed, for frequency of application, the exception may swallow the rule: imputed interest won't be involved where the taxpayer (or spouse, if both live in the facility) is 62+ by year-end. I.R.C. § 7872(h).

2. Are there differences in the way components of hospital charges, and those of nursing homes and other institutions, are treated?

Yes. The costs of in-patient hospital care (including meal and lodging components, even if separable) are fully deductible as medical care expenses. But whether the costs of care in an "institution other than a hospital" are deductible is a question of fact, based on the types of care needed by an individual and the services received. Treas. Reg. § 1.213-1(e)(1)(v). Where the availability of medical care is a principal reason for a taxpayer's stay in such an institution, then all the costs incurred during the period while the taxpayer requires continual medical care are deductible. But if medical care is not a principal reason for the stay, only the separable costs of medical services are deductible. *Id.*

No specific definition of an institution other than a hospital has been provided by administrative pronouncements or the courts, but it should include a private establishment "regularly engaged" in providing medical care services. *Id.* Nursing homes should qualify.

The costs of an assisted living facility – an institution that provides long-term care services - can also be deductible when (i) a taxpayer has been certified by a licensed health practitioner as chronically ill and (ii) the taxpayer resides in the facility pursuant to a plan of care. See further discussion of long-term care services below.

C. Other payments for in-home services (i.e., for those who want to "age in place") or separately charged services provided in and by institutions or senior-focused residential communities

Whether a taxpayer is billed for separately itemized services or an estimate is used for a deductible portion of recurring charges, costs for either medical care under Treas. Reg. § 1.213-1(e)(1)(ii) or for long term care services under IRC § 7702B(c) are deductible.

1. What in-home services are classified as IRC § 213(d)(1)(A) medical care ("diagnosis, cure, mitigation…")?

Costs of nursing services are deductible, including the caregiver's meals and (only the incremental costs of) lodging when applicable. Costs of healing services, such as assistance with recovering function or physical therapy after a surgical procedure, are also deductible. Treas. Reg. § 1.213-1(e)(1)(ii); Rev. Rul. 76-106, 1976-1 CB 71. Nursing services include services by persons who are not licensed as nurses; the services provided, not the credentials of service providers, determine what is deductible. *George B. Wendell v. Commissioner*, 12 TC 161, 162 (1949). Examples of services treated as nursing services include help with transferring, grooming, bathing, monitoring blood pressure, and assistance with taking medications. In many cases where other requirements are met (see below) such services could also be characterized as long-term care services.

Note, however, that services provided by a relative (as defined for purposes of dependency exemptions under IRC § 152(d)(A) through (G)) or a spouse won't be deductible unless the caregiver *is a licensed health care practitioner*. IRC § 213(d)(11)

2. What in-home services are classified as IRC § 213(d)(1)(C) long-term care services?

a. Requirements in addition to types of services provided

Long term care services under IRC § 213(d)(1)(C), via the cross-reference to IRC § 7702B(c), include "…necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services…" that are
(i) required by a chronically ill individual who has been certified as such within the last 12 months by a licensed health care practitioner, and
(ii) provided pursuant to a plan of care prescribed by a licensed health care practitioner

b. Definition of "chronically ill"

An individual is chronically ill within the meaning of IRC § 7702B(c)(2) if certified as
(i) being unable to perform, without substantial assistance from another individual, at least two activities of daily living (eating, toileting, transferring, bathing, dressing, continence) for at least 90 days due to a loss of functional capacity;
(ii) having a similar level of disability as determined under IRS regulations prescribed in consultation with the Department of Health and Human Services [none to date other than Notice 97-31, below]; or
(iii) requiring substantial supervision to protect the individual from threats to health and safety due to severe cognitive impairment

Example: A taxpayer, 85, has a stroke and thereafter needs help dressing, bathing, eating, toileting, as well as ongoing medical attention (blood pressure monitoring). His doctor recommends that he enter a nursing home to have access to care and services, and the taxpayer does so. The nursing home charges are deductible because the institution is regularly engaged in providing medical care and a principal reason for the taxpayer's move into the institution is to obtain that care.
Variation: The taxpayer doesn't require ongoing medical attention but still needs custodial care for ADLs that he's unable to perform. His doctor recommends that he enter an assisted living facility. The taxpayer is certified by the doctor as chronically ill and entry is pursuant to a plan prescribed by the doctor (who is a licensed health care practitioner). The charges are deductible because they are long-term care services.

3. When is it necessary to separate deductible and non-deductible portions of charges for personal care services?

When the in-home caregiver also provides household services such as cleaning or cooking, the cost must be allocated between the deductible and non-deductible portions. Rev. Rul. 76-106, 1976-1 CB 71. Note again here that (with the exception of someone related to the taxpayer) the person(s) providing the services need not have medical licenses as a condition for the costs of the medical care portion of such services to be deductible.
John Frier, TC Memo 1971-84, 71-365.

4. How do payments received under long-term care insurance contracts affect the deduction of costs incurred for care?

CAUTION: The following applies to long-term care insurance coverage for which all premium payments were made from the insured's after-tax funds. Benefit payments received under a long-term care insurance contract for which premium payments were made pre-tax through an employee benefit program (*i.e.*, by using withdrawals from a Health Savings Arrangement offered in a cafeteria plan) are generally includible in gross income. IRC § 106(c)(1). The actual costs incurred for long-term care services during periods covered by such benefit payments will need to be treated as part of medical care itemized deductions.

a. Types of long-term care insurance contracts

Long-term care insurance benefits generally are provided under (i) reimbursement contracts, as payment of expenses actually incurred and claimed or (ii) indemnity contracts, where specific amounts are paid (often on a per-diem basis) during periods when eligibility criteria for payment of benefits have been satisfied, regardless of actual expenses incurred.

A contract of either type that is a qualified long-term care insurance contract, as defined in IRC § 7702B(b), is treated as a health or accident insurance contract, and payments received under the contract are treated as reimbursements of expenses actually incurred for medical care. IRC §§ 7702B(a)(1) and (a)(2). Note that this treatment also applies with a rider to or part of a life insurance or annuity contract, in which case the long-term care coverage is treated as a separate contract. IRC § 7702B(e)(1).

b. When payments received are entirely excludible from gross income and when only partially so

Payments under qualified long-term care insurance contracts are not included in gross income, but instead reduce the deductions for care costs incurred, subject to an exception (and an exception to the exception), immediately below.

When benefits are received for qualified long-term care services from indemnity policies, the exclusion from gross income is limited. IRC § Sec. 7702B(d). For 2020, the excludable amount is $380 per day (or an equivalent amount if payments are made on another periodic basis), or $138,700 for the full year. Rev. Proc. 2019-44, 2019-47 IRB 1093.

Thus, when (i) costs incurred for qualifying care are less than the per-diem limit, and (ii) payments under a qualifying contract exceed the actual costs but still are less than the per-diem limit, the entire amount paid is excludible. However, if actual costs of the care exceed the per-diem limit, then the limit is essentially increased to equal the amount of costs actually incurred, so that the entire amount is still treated as excludible. IRC § 7702B(d)(2). Otherwise, if actual costs incurred are less than the per-diem limit but payments received under the contract exceed that limit, the amount received in excess of the limit is fully taxable.

Example: A **t**axpayer is certified as chronically ill by a licensed practitioner and, pursuant to a plan of care prescribed by that practitioner, moves into a skilled nursing facility on May 1, 2020. The taxpayer has an indemnity type long-term care insurance policy (for which all premiums have been paid with the taxpayer's after-tax funds) that will begin paying benefits based on this triggering event. The policy has a 90-day elimination period, and thereafter pays $400 per day, *i.e.*, from July 31, 2020, or for 154 days during the rest of the year, $61,600. The per-diem limit for this period is $380 x 154, or $58,520. However, the taxpayer's actual costs for occupancy and all other services in the facility for the period are $64,000. No part of this amount is covered by any other insurance or otherwise. Therefore, while payments during this period exceed the per-diem limit, actual costs incurred are more than the total payments, so the entire amount is excludible from gross income. The difference ($64,000 actual cost - $61,600 benefit payments) is potentially deductible as a medical care expense (but subject to the AGI floor).
Variation: If the actual costs for July 31 – December 31, 2020 were $60,000, the per-diem limit would effectively be increased to $60,000, and that much of payments received under the

contract would be excluded from gross income. The remaining $1,600 of the total $61,600 received would be includible in the taxpayer's gross income.

Notwithstanding this per diem limit on the excludability of payments received under indemnity contracts, if payments are made to an insured who is terminally ill, as defined in IRC § 101(g), then the entire amount can be excluded from gross income. IRC § 7702B(d)(1).

D. Travel and local transportation to obtain medical care

Costs of travel or local transportation that are *primarily for* the purpose of obtaining medical care and *essential to* obtaining such care are deductible. IRC § 213(d)(1)(B); Treas. Reg § 1.213-1(e)(1)(iv).

1. Will travel or transportation costs be deductible even if the taxpayer doesn't choose the closest provider for the care needed?

Yes, if the costs meet the primarily-for and essential-to requirements. There is no additional requirement that a medical care provider chosen by the taxpayer must be the closest or cheapest one. Thus, if a taxpayer travels to obtain care, and the caregiver does not practice in the area of the taxpayer's tax home, the primarily-for and essential-to requirements can be satisfied even when similar care can be obtained nearby. *Stanley D. Winderman v. Commissioner*, 32 TC 1197, 1199 (1959).

In *Winderman*, a taxpayer who had previously resided in New York, and who moved to Los Angeles, continued to make annual trips to New York for consultations with and examinations by a physician located there, with whom he had a long association. Finding that the trips otherwise met the requirements for deductibility, the court stated that the taxpayer wasn't obligated to seek a new physician in the Los Angeles area.

2. Are costs of a companion for travel to obtain medical care deductible?

Yes. When it is necessary for another person to accompany a patient in traveling to obtain medical care or for therapeutic reasons on the recommendation of a physician (*e.g.*, avoiding a season of extreme heat or cold when the patient has a heart or lung ailment exacerbated by such extremes), the costs of that other person's travel can also be deducted by the patient/taxpayer. *Cohn v. Commissioner*, 38 TC 387, 390 (1962), *acq.*, 1963-1 C.B. 4; Rev. Rul. 58-110, 58-1 CB 155; PLR 8321042.

Example: A taxpayer's illness makes him too weak to negotiate air travel alone, so his wife accompanies him on a flight to a clinic located in another state, where the taxpayer will receive specialized treatment. The costs of the air travel for both the taxpayer and spouse are deductible medical expenses if the trip is primarily for and essential to obtaining medical care. IRC § 213(d)(2).

3. Where travel costs incurred to obtain care are deductible, are temporary lodging and meals while away from home receiving the care also deductible?

For lodging, yes, subject to a limitation. Lodging costs incurred while away from home to obtain a physician's services in a licensed hospital (or similar facility) on an out-patient basis are deductible, if there is no significant element of personal pleasure involved in the lodging, the costs are not lavish or extravagant, and the lodging is primarily for and essential to obtaining the services (*i.e*., because the hospital is not within the tax home of the patient). The deductible amount is limited to $50 per night per person. [This amount is not subject to cost-of-living adjustments.] IRC § 213(d)(2).

In general, meal costs associated with travel to obtain care do not appear to be deductible, since they are treated as personal living expenses. No exception appears to be available, even for the incremental costs of a special diet prescribed for a period pre-or post-surgery, if it substitutes for one's normal nutritional requirements. Rev. Rul. 2002-19, 2002-1CB 779. Only if food items are prescribed solely for the treatment or alleviation of an illness (*e.g*., for ulcers), and they are in no way part of normal nutritional needs, may the costs be deducted. Rev. Rul. 55-261, 1955-1 CB 307.

III. Tax strategies with final medical expenses

A. Alternative treatments of medical bills unpaid on the date of death

1. What charges for an individual's medical care that are paid after his or her death can be deducted for either income or estate tax purposes?

If a decedent's final medical care charges are paid out of his or her estate during a period of one year beginning the day after the decedent's date of death, the executor (as defined in Treas. Reg. § 20.2203-1) can elect to have them treated as if they were paid when incurred, and deduct them on the decedent's final income tax return (Form 1040) or the return for an earlier year if such expenses remained unpaid. IRC § 213(c). The election to deduct medical care charges unpaid at death on the final Form 1040 can be made for any portion (including none or all) of such charges. For this purpose, the expenses are incurred at the time services are rendered, regardless of the date of billing. Treas. Reg. § 1.213-1(d)(1).

Practice tip: While the deadline for making this election is later than the deadline for filing a federal or Minnesota estate tax return, very often these returns are filed by their extended, rather than original, due dates. The opportunity to make this election regarding unpaid medical bills, by paying them within one year of the decedent's date of death, can be overlooked and lost unless the one-year anniversary date is calendared for this purpose.

2. What must be done to elect to claim medical care charges paid within a year of death on the decedent's final income tax return?

The executor makes the election on the decedent's final Form 1040. Treas. Reg. § 1.213-1(d). If election will be made, the executor need not file an estate tax return solely for this purpose if the return isn't otherwise required. The election statement should be submitted in duplicate. *Id.* (With paper-filed returns, this is straightforward; when e-filing, this probably requires a pdf attachment to the transmission.) The trade-off for this election is a waiver of the right to claim the deduction at any time for estate tax purposes.

A sample election is included as an appendix.

Example: A taxpayer dies on February 12, 2020 after a long illness. At the time of his death, $40,000 of medical expenses incurred for care in the latter part of 2019, and $30,000 of medical expenses incurred for care in January and February of 2020, remain unpaid and confirmed to be the taxpayer's responsibility (no private insurance or Medicare coverage will apply). The executor of the taxpayer's estate can elect, on the taxpayer's 2019 Form 1040, to deduct the $40,000 of medical expenses incurred that year. The executor can also elect, on the taxpayer's final Form 1040 (for 2020) to deduct the $30,000 of medical expenses incurred for that year. Without either election, the entire $70,000 will be deductible as a debt of the decedent on the taxpayer's estate tax return.

Even in cases where the marginal income tax rate is higher than the marginal estate tax rate, costs claimed on an estate tax return won't be reduced by a floor. Also, the marginal income tax rate has no significance unless total itemized deductions exceed the applicable standard deduction, so the first step in any comparison of the tax savings must be to determine whether itemized deductions will be used for the final income tax return.

B. Additional concerns when the income tax deduction will be claimed

1. How is the choice of filing status for married individuals in the year when one (or both) spouses dies determined?

a. When "running the numbers" is worthwhile

A surviving spouse generally can file a married-joint income tax return with his or her deceased spouse for the year of the death, unless the surviving spouse remarries before the end of that year. Joint filing is also available for a tax year in which both spouses die. Treas. Reg. §§ 1.6013-1(d)(1) and (2). Normally, filing a joint return results in a lower federal and state income tax liability than what would be the combined liabilities from filing two married-separate returns.

However, married-separate returns can also be filed. IRC § 1(d). One of the relatively uncommon situations in which this choice can result in a lower combined tax liability is when one spouse has large uninsured medical care costs but also relatively modest gross income. A married-separate return for that spouse may allow a larger medical care deduction to exceed the AGI "floor", potentially offsetting other disadvantages (*e.g.*, a more compressed tax rate structure) of that filing status, so that the sum of the spouses' married-separate tax liabilities actually is less than what would be their married-joint liabilities.

Because so many aspects of federal and Minnesota individual income tax returns are impacted by AGI, and because some tax benefits are simply unavailable to married-separate filers, it is very difficult to judge without actual calculations when separate returns may result in less overall tax liability. But whenever uninsured medical expenses are significant the return preparer should do this comparison. (Many tax return preparation software packages can produce reports for this purpose.)

b. Need for coordination when two married-separate returns will be filed

In doing any comparison of the results of filing a married-joint or two married-separate returns, bear in mind that, if one spouse's married-separate return uses itemized deductions (rather than the standard deduction), the other spouse's married-separate return must also use itemized deductions, even if less than the applicable standard deduction. IRC § 63(c)(6). Thus, the first married-separate return to be filed locks in the choice for the other spouse's return.

2. How are medical care expenses unpaid at death treated if the decedent was a dependent of another person?

Charges for medical care provided to a taxpayer's dependent (*e.g.*, an elderly person who was the dependent of one of his or her children) can only be deducted in the tax year of payment. This is the case even for charges incurred in the final year of the dependent's life. The above rule allowing relation-back of the deduction to the year in which the costs were incurred (for payments during the one-year period after the decedent's date of death) apparently does not apply if the decedent was the dependent of another taxpayer. *Charles Reynolds et. ux.*, TC Memo 2000-20, 132-33.

APPENDIX: Sample election to claim final medical expenses on last individual income tax return

Election to Claim Medical Expenses Paid within One Year of Death on Decedent's Final Individual Income Tax Return

Alfred Taxpayer, deceased XX/XX/20XX
Social Security Number 111-22-3333
Form 1040 (20XX)

The undersigned Personal Representative of the Estate of Alfred Taxpayer (TIN 44-5555555) hereby elects pursuant to IRC § 213(c) and Treas. Reg. § 1.213-1(d) to claim the following expenses, paid within one year of the decedent's death, as deductions from the decedent's gross income on the individual income return to which this election statement is attached:

Description	Amount
Hospital charges	$6,700
Ambulance	1,200
Prescription drugs	600
Total	$8,500

To the best of the Personal Representative's knowledge and belief, none of the above-listed expenses have been or will be reimbursed by insurance or otherwise. The above-listed expenses have not been allowed as deductions under IRC § 2053 in computing the decedent's taxable estate for estate tax purposes, and the undersigned hereby waives the right to have them allowed as estate tax deductions at any time.

/s/____
Personal Representative, Estate of Alfred Taxpayer