

## Tax aspects of a parent entering a nursing home

Dear Client:

If your parent will be entering a nursing home, below is an explanation regarding whether amounts paid for long-term medical care (including amounts paid to the nursing home) are deductible, whether insurance premiums covering the cost of long-term care including nursing home expenses (for the part of the year before your parent enters the nursing home) are deductible, and whether the gain on the sale of your parent's home will qualify for the \$250,000 exclusion. These matters and other tax aspects which you should consider in connection with your parent entering a nursing home are discussed.

**Deductibility of long-term medical care services.** The costs of qualified long-term care, including nursing home care, are deductible as medical expenses to the extent they, along with other medical expenses, exceed 7.5% of adjusted gross income. Qualified long-term care services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal-care services required by a chronically ill individual provided under a plan of care presented by a licensed health-care practitioner.

To qualify as chronically ill, an individual must be certified by a physician or other licensed health-care practitioner (e.g., nurse, social worker, etc.) as unable to perform without substantial assistance at least two activities of daily living (eating, toileting, transferring, bathing, dressing, and continence) for at least 90 days due to a loss of functional capacity, or as requiring substantial supervision for protection due to severe cognitive impairment (memory loss, disorientation, etc.). A person with Alzheimer's disease qualifies.

**Deductibility of premiums paid for qualified long-term care insurance.** Premiums paid for a qualified long-term care insurance contract are deductible as medical expenses (subject to an annual premium deduction limitation based on age, as explained below) to the extent they, along with other medical expenses, exceed 7.5% of adjusted gross income. A qualified long-term care insurance contract is insurance that provides coverage only for qualified long-term care services, doesn't pay costs that are covered by Medicare, is guaranteed renewable, and doesn't provide for a cash surrender value. A policy isn't disqualified merely because it pays benefits on a per diem or other periodic basis without regard to the expenses incurred during the specific payment period. Qualified long-term care premiums are includible as medical expenses up to the following dollar amounts: For individuals over 60 to 70 years old, the 2011 limit on deductible long-term care insurance premiums is \$3,390 (\$3,290 for 2010), and for those over 70, \$4,240 (\$4,110 for 2010).

**Deductibility of amounts paid to the nursing home.** Amounts paid to a nursing home are fully deductible as a medical expense if the principal reason that a person stays at the nursing home is for medical, as opposed to custodial, etc., care. If a person isn't in

the nursing home principally to receive medical care, then only the portion of the fee that is allocable to actual medical care qualifies as a deductible medical expense. But if the individual is chronically ill (as defined above), all of the individual's qualified long-term care services, including maintenance or personal care services, are deductible.

**Including medical expenses you pay for your parent as part of your deductible medical expenses.** If your parent qualifies as your dependent under the rules discussed below, you can include any medical expenses you incur for your parent along with your own when determining your medical deduction. If your parent doesn't qualify as your dependent only because of the gross income or joint return test ((b) and (c), below), you can still include these medical costs with your own.

**Claiming a parent confined to a nursing home as a dependent.** You may be able to claim your parent as a dependent, thus qualifying for an exemption, even though your parent is confined to a nursing home. To qualify, (a) you must provide more than 50% of your parent's support costs, (b) your parent must not have gross income in excess of the exemption amount (\$3,650 in 2010), (c) your parent must not file a joint return for the year, and (d) your parent must be a U.S. citizen or a resident of the U.S., Canada, or Mexico. Your parent can qualify as your dependent even though he or she doesn't live with you, provided the support and other tests mentioned above are met. Amounts you pay for qualified long-term care services required by your parent and eligible long-term care insurance premiums, discussed above, as well as amounts you pay to the nursing home for your parent's medical care, are included in the total support you provide. If the support test ((a) above) can only be met by a group (you and your brothers and sisters, for example, combining to support your parent), a multiple support form can be filed to grant one of you the exemption, subject to certain conditions.

**Qualification for head-of-household filing status.** If you aren't married and you are entitled to claim a dependency exemption for your parent, you may qualify for the head-of-household filing status, which is more favorable than the single filing status. You may be eligible to file as head of household even if the parent for whom you claim an exemption doesn't live with you. In order to qualify for head-of-household status, generally you must have paid more than half the cost of maintaining a home for yourself and a qualifying relative for more than half the year. In the case of a parent, however, you may be eligible to file as head of household if you pay more than half the cost of maintaining a home that was the principal home for your parent for the *entire* year. Thus, if your parent is confined to a nursing home, you are considered to be maintaining a principal home for your parent if you pay more than half the cost of keeping your parent in the nursing home.

**Exclusion of gain on sale of your parent's home.** If your parent sells his or her home, up to \$250,000 of the gain from the sale may be tax-free. In most cases, the seller, in order to qualify for this \$250,000 exclusion, must have (a) owned the home for at least two years out of the five years before the sale, and (b) used the home as his or her principal residence for at least two years out of the five years before the sale. However, there is an exception to the two-out-of-five-year use test under (b) if the seller becomes physically or mentally unable to care for him or herself at any time during the five-year period.

Your parent can qualify for this exception to the use test if, during the five-year period before the sale, your parent (1) becomes physically or mentally unable to care for him or herself, and (2) your parent owned and lived in the home as his or her principal residence for a total of at least one year. Under this exception, your parent is treated as using the home as his or her principal residence during any time during the five-year period in which he or she owns the home and resides in any facility (including a nursing home) licensed by a state or political subdivision to care for an individual in your parent's condition.

**Exclusion for payments under life insurance contracts.** If your parent is terminally or chronically ill and is insured under a life insurance contract, he or she may be able to receive tax-free payments (accelerated death benefits or so-called "viatical" payments) while living. Any lifetime payments received under a life insurance contract on the life of a person who is either terminally or chronically ill are excluded from gross income. A similar exclusion applies to the sale or assignment of a life insurance contract to a person who regularly buys or takes assignments of such contracts and meets other qualifying standards. These lifetime payments could be used to help pay the costs of your parent's nursing home.

**Reverse mortgage as alternative to nursing home.** It is often desirable for an elderly person to remain in his or her own home with proper in-home care rather than entering a nursing home. A reverse mortgage loan may make this a feasible alternative. Many states permit a reverse mortgage loan, which is designed to permit elderly persons with limited income to remain in their homes by borrowing against the value of their homes.

Typically, a bank commits itself to a principal amount based on the appraised value of the property, which is loaned to the borrower in installments over a period of months or years. The monthly installments can be used to help pay for the upkeep of the home and for in-home care. Repayment of the loan is due when the principal amount has been fully paid to the borrower, or the residence that secures the loan is sold, or the borrower dies or ceases to use the home as his principal residence.

The loan agreement may provide that interest will be added to the outstanding loan balance monthly as it accrues. However, the borrower can't deduct this interest until it is actually paid.

If you wish to discuss your situation further, please call us at 978-854-5656.

Sincerely,

*Neal A. Price & Company, LLP*

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