

# The ElderLaw Report

Editors

Harry S. Margolis, Esq.  
Kenneth M. Coughlin

## Identifying Some Key Tax Benefits for Parents of Children with Special Needs

By Thomas M. Brinker, Jr., and W. Richard Sherman

### In This Issue

**New Minimum MMNA Announced . . . . . 2**

**Medicaid Proposes Allowing Recipients to Direct Own Home Care . . . . . 3**

**Tax Benefit Checklist for Families Caring for Special Needs Children . . . . . 4**

**Pennsylvania's Assault on Annuities Continues Post-DRA . . . . . 5**

**Keeping Current . . . 6**

- *In the Estate of Shuh*
- *Pack v. Osborn*
- *In Re Lynch v. Comm'r of the NY State DOH*
- *Smith v. McCann*
- *Chicago Tit. Ins. Co. v. Mazula*

**Practice Tips . . . . . 8**

As the number of children diagnosed with autism, Asperger's syndrome, and other neurological disorders continues to skyrocket, the disruption of the lives of all those concerned is unmistakable—as are the costs of providing care for the special needs child. As reported by the Autism and Developmental Disabilities Monitoring (ADDM) Network, as many as 1 out of 150 children are born today with an autism spectrum disorder ([www.cdc.gov/ncbddd/autism/asd.htm](http://www.cdc.gov/ncbddd/autism/asd.htm)). Further complicating the situation, parents with special needs children are often unaware of the substantial tax benefits that are available to them and forego hundreds, if not thousands, of potential tax deductions and reductions in their tax liability. Michael A. O'Connor, an attorney who has written extensively on this topic, believes that 15 percent to 30 percent of families with a disabled child have one or more unclaimed tax benefits ([www.wrightslaw.com/info/tax.2005.benefits.oconnor.htm](http://www.wrightslaw.com/info/tax.2005.benefits.oconnor.htm)). Among these potential tax benefits are deductions or credits for medical expenses, special instruction, impairment-related work expenditures, and the earned income tax credit. The following article gives a brief overview of some of the more common deductions and credits that may be available under current tax law.

deductible as a medical expense if the principal reason for the individual's attendance is to alleviate the handicap through the resources of the school or institution. This deduction may also include amounts paid for lodging, meals, transportation, and the cost of ordinary education incidental to the special services provided by the school. Also, any costs incurred for the supervision, care, treatment and training of a physically and/or mentally handicapped individual are deductible if provided by the institution.

### *The Rationale Behind the Special Education and Training Deduction*

Under US law, all children are entitled to an equal and appropriate (public) education. Many public schools, however, do not have special programs or facilities to handle the needs of mentally or physically handicapped children. As a result, it is sometimes necessary for such children to attend special schools where the focus is not only on education, but also on alleviating the handicap of the child. The cost of these special schools is not always covered by the government or the school district and, therefore, the parents must pay for all or a portion of the tuition. However, if the school qualifies as a special school, the entire unreimbursed cost (subject to the 7.5 percent adjusted gross income limitation) incurred by the parents is deductible as a medical expense. Alternatively, parents who are eligible to participate in tax-advantaged plans through work for funding medical expenses, such as flexible spending accounts or health savings accounts, can set aside limited amounts of money to finance medical care expenses on a pre-tax basis while bypassing the 7.5 percent AGI limitation.

### *Special Instruction Qualifying as Medical Expense Deductions*

In general, costs related to providing a child's traditional education are not considered medical care and, therefore, are not deductible as a medical expense. However, according to Treasury Regulation 1.213-1(e)(1)(v), the unreimbursed cost of attending a special school for a mentally or physically handicapped individual is

## Special Schools

A special school is distinguishable from a regular school by the substantive content of its curriculum. A special school may offer ordinary education, but it must be incidental to enabling the student to compensate for or overcome a handicap so that he or she will be prepared for future normal education or normal living (*i.e.*, "mainstream"). A special school is not determined by the institution as a whole, but by the nature of the services received by the individual for whom a medical care deduction is sought. The IRS considers the medical facilities and therapeutic orientation of a school as critical factors in determining whether a school is a special school for a qualifying medical care deduction. Case law and IRS administrative rulings reveal a litany of examples considered special schools by the IRS:

- Schools for teaching Braille to the blind or lip reading to the deaf;

## The ElderLaw Report

### EDITORS

Harry S. Margolis  
Kenneth M. Coughlin

Developmental Editor  
Matthew Isler

Publisher  
Jon Eldridge

Editorial Director  
Beverly Salbin

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought—*From a Declaration of Principles jointly adopted by a Committee of the American Bar Association and a Committee of Publishers.*

© 2008 by Harry S. Margolis

The ElderLaw Report (ISSN 1047-7055) is published monthly, except bimonthly July/August, by Aspen Publishers, 76 Ninth Avenue, New York, NY 10011.

One year subscription costs \$234.

To subscribe, call 1-800-638-8437. For customer service, call 1-800-234-1660. Send address changes to The ElderLaw Report, Aspen Publishers, 7201 McKinney Circle, Frederick, MD 21704.

All rights reserved. This material may not be used, published, broadcast, rewritten, copied, redistributed or used to create any derivative works without prior written permission from the publisher. Printed in U.S.A.

Permission requests: For information on how to obtain permission to reproduce content, please go to the Aspen Publishers website at [www.aspenpublishers.com/permissions](http://www.aspenpublishers.com/permissions). Purchasing reprints: For customized article reprints, please contact Wright's Reprints at 1-877-652-5295 or go to the Wright's Reprints website at [www.wrightsreprints.com](http://www.wrightsreprints.com).

[www.aspenpublishers.com](http://www.aspenpublishers.com)

## New Minimum MMNA Announced

The new minimum monthly maintenance needs allowance (MMMNA), to take effect no later than July 1, 2008, will be \$1,750 (up from the current \$1,711.25) in the lower 48 states and the District of Columbia. The MMMNA is 150 percent of the monthly poverty guideline for a couple, which is now \$14,000. All the Poverty Income Guidelines can be found at: <http://aspe.hhs.gov/poverty/08poverty.shtml>

- Schools for training the mentally retarded;
- A military school that accepted a physically and mentally handicapped student (the school gave personal daily attention to the student to improve upon the student's low attention span);
- A boarding school recommended by a psychiatrist (the school had psychiatrists, psychologists, and social workers who developed a special program for each student);
- Schools for average and above-average students with learning disabilities that provide an environment in which the students can adjust to a normal competitive classroom situation; and
- A regular school's curriculum that is specially designed to accommodate the needs of handicapped children with IQ scores ranging from 50 to 75.

Furthermore, regular schools with special curricula can be classified as a special school for an individual. For example, in one Revenue Ruling, the school in question had a special curriculum for mentally disabled children with the special curriculum representing a separate component of the school's activities. Since the school's special education curriculum was a severable aspect of the school's activities, the IRS ruled that the special curriculum was a special school (*Rev. Rul. 70-285, 1970-1 CB 52*).

In another case, the IRS specifically ruled that a taxpayer whose child suffers from severe learning disabilities caused by a neurological disorder (*i.e.*, autism spectrum disorder) may deduct as a medical expense amounts paid for tuition and related fees for the child's education at a special school that has a program designed to "mainstream" these children so they can return to a regular school. The Ruling further held that amounts paid for private tutoring by a specially trained teacher (*i.e.*, therapeutic and behavioral support services) qualified to deal with severe learning disabilities is also deductible. However, both the special school and tutoring need to be recommended by a physician (*Revenue Ruling 78-340 (1978-2 CB 124)*).

In a Letter Ruling issued in 2005, the IRS expanded the definition of special schooling to include tuition for programs enabling dyslexic children to deal with their condition. The IRS ruled that the children were

attending the school for the principal purpose of obtaining medical care in the form of special education. The special education was required for the years in which the children were diagnosed as having a medical condition (including dyslexia) that impaired their ability to learn. As a result, the IRS ruled in favor of a medical expense deduction for the tuition paid to the school (*Letter Ruling 200521003*).

### ***Deduction for Medical Conferences and Seminars***

Parents of special needs children often attend medical conferences and seminars in order to learn more about their child's disability. Using the authority of Revenue Ruling 2000-24 (2000-1 CB, 1133), the amounts paid for the registration fees and travel expenses are deductible as medical expenses. However, parents should obtain the recommendation of their child's doctor to ensure their medical deduction. In addition, the Ruling did not extend medical care deductibility to any meals or lodging costs incurred while attending the conference. Furthermore, the conference or seminar must deal specifically with the medical condition from which the child suffers, not just general health and well-being issues. As with the special instruction and other medical expenses, the aggregate amount of all medical expenses incurred must exceed 7.5 percent of the taxpayers' AGI to be deductible.

### ***Deductions for Dependents***

In order to claim a dependency exemption (\$3,500 for 2008), a taxpayer must satisfy a five-prong test. The taxpayer must provide more than half of the dependent's support (the Support Test). The dependent must be a "qualifying relative" or member of the taxpayer's household for the entire year (the Relationship Test). The dependent's gross income cannot exceed the exemption amount (the Gross Income Test). If married, the dependent cannot file a joint return for the year (the Joint Return Test). The dependent must be a US citizen or resident or a resident of Canada or Mexico (the Citizenship or Residency Test). With passage of the Working Families Tax Relief Act of 2004 (taking effect for 2005 and years thereafter), the definition of a "qualifying child" or a "qualifying relative" was clarified to provide a uniform definition for purposes of dependency exemptions, child tax, dependent care, and earned income tax credits. Under this definition, in addition to meeting the relationship test [taxpayer's child, stepchild, eligible foster child, or descendent (e.g., grandchild) or taxpayer's brother, sister, or descendent (e.g., niece, nephew)], a "qualifying child" must meet any ONE of the following three requirements:

1. The individual must be under the age of 19 at year end; OR

## **Medicaid Proposes Allowing Recipients to Direct Own Home Care**

The Centers for Medicare & Medicaid Services (CMS) has proposed a new rule that would give beneficiaries a cash allowance to hire, direct, train or fire their own personal care workers to help with things like preparing meals, household chores and other related services that help a person live independently. Beneficiaries could even hire qualified family members who may already be familiar with the individual's needs to perform personal assistance (although not medical) services.

In addition, the allowance could be used for assistive technologies or home modifications that could reduce dependency on human assistance, such as a wheelchair ramp or microwave oven. The beneficiaries also have the option to have their cash benefit allotment managed for them.

The innovation, called Cash and Counseling, was field tested in three states—Arkansas, Florida and New Jersey. A study found that disabled Medicaid recipients living at home who were allowed to direct their own care were more satisfied with their care and spent less money on nursing homes than those using Medicaid's traditional agency-provided services.

The proposal would put into place a provision of the Deficit Reduction Act of 2005 that allows states to elect a state plan option to provide care in ways previously required by waivers. States must apply for approval of this plan option, and states choosing the option must have necessary quality assurances and other safeguards in place to assure the health and welfare of participants.

2. The individual must be a full-time student under the age of 24 at the end of the year (qualifying "students" must be enrolled as a "full-time" student during any part of five calendar months during the year); OR
3. The individual must be totally and permanently disabled at any time during the year.

It is important to note that grandparents, uncles, aunts, brothers and sisters satisfy this "relationship" test and, therefore, may be allowed to claim the dependency exemption for a "qualifying child" who is totally or permanently disabled, regardless of the age of that child.

### ***Impairment-Related Work Expenditures***

As special needs individuals mature and enter the workplace, many of these individuals are entitled to claim itemized deductions for their unreimbursed impairment-related work expenses. The IRC, under Section 190(b)(3), defines "handicapped individuals"

as those having a physical or mental disability or impairment (*i.e.*, blindness or deafness, or impaired sight or hearing) that is a functional limitation to employment, or substantially limits one or more major life activities. Impairment-related work expenses refer to expenses incurred by a handicapped individual that are for attendant care services at the place of employment. According to IRC Section 67(d), these expenses must represent expenditures necessary to enable the individual to maintain employment.

According to the instructions provided by the IRS in its Publication 502: Medical and Dental Expenses for 2007 (page 24), an employee can deduct

impairment-related work expenses on his or her Form 2106 or Form 2106-EZ. These expenditures are then transferred to Form 1040's Schedule A as an unreimbursed business expense that is not subject to the two percent AGI limitation on miscellaneous itemized deductions.

### *Earned Income Tax Credit*

Historically, the idea behind the Earned Income Tax Credit (EITC) is to encourage the economically disadvantaged to work by partially offsetting the Social Security taxes on wages. Appropriately, the EITC is not available to taxpayers who have unearned income (*i.e.*,

## **Tax Benefit Checklist for Families Caring for Special Needs Children**

### ***Medical Expense Deductions***

#### **1. *Deducting the cost of a Special School or Institution***

##### **a. *What is a Special School?***

- Schools with programs to "mainstream" children with neurological disabilities (*i.e.*, autism spectrum disorders)

##### **b. *What is deductible?***

- Lodging, meals, transportation, incidental educational costs provided by the institution, and costs of supervision, care, treatment, and training.

#### **2. *Regular Schools can be classified as a "Special School" for an individual***

- Where School has special curriculum for mentally disabled individual

#### **3. *Private tutoring by a specially trained teacher***

- Therapeutic and behavioral support services (see Revenue Rulings 70-285 and 78-340 for A, B, and C)

#### **4. *Special education for dyslexic children***

- Provided program enables children to deal with disability caused by medical condition (2005's Letter Ruling 200521003)

#### **5. *Deduction for Medical Conferences and Seminars***

- Both transportation and conference fees deductible under Revenue Ruling 2000-24

#### **6. *Prescribed Vitamin Therapy***

#### **7. *Prescribed Equestrian Therapy***

#### **8. *Medical Travel and Transportation***

- For 2007 tax returns: .20 per mile
- For 2008 tax returns: .19 per mile
- Lodging costs (but not meals) up to \$50 per day are deductible for the taxpayer and one additional person if an overnight stay is necessary

Note: Unreimbursed medical expenses are deductible only to the extent the taxpayer itemizes his or her deductions (Schedule A) and they exceed 7.5 percent of their Adjusted Gross Income (AGI) [10 percent of AGI for the Alternative Minimum Tax (AMT)].

#### **9. *Consider FSA Health Care Plan if ineligible for medical expense deduction.***

#### **10. *Impairment-Related Work Expenses***

- Business deduction in lieu of a medical deduction for attendant care services at place of employment (ordinary and necessary expense to help in performing job)
- Avoids 7.5 percent AGI limitation imposed on unreimbursed medical expenses
- NOT subject to 2 percent AGI limitation imposed on unreimbursed employee business expenses

#### **11. *Expanded definition of a "qualifying child"***

- Special needs individual can be older than 19 or 24 and claimed as a dependent
- No gross income limitation for a "qualifying child"

#### **12. *Credit for Special Needs Adoption Expenses***

- \$11,650 for a special needs child in 2008, regardless of adoption expenses
- Must be a US citizen or resident and requiring adoption assistance
- Qualifying expenses include: legal fees, court costs, and other related adoption costs
- The limit is per child, not per year (carryover of five years)
- Credit is phased-out for taxpayers with adjusted gross incomes exceeding \$174,730 in 2008. The credit is completely phased-out at \$40,000 above the threshold

—TMB and WRS

dividends, interest, gains of sales of securities) above a specified threshold (\$2,950 in 2008). Families filing a married joint return with adjusted gross income in 2008 under \$41,646 (\$3,000 less if a taxpayer is filing as single or head of household) may qualify for the EITC based on the presence of two "qualifying children" in the taxpayer's home. For EITC purposes, a "qualifying child" uses the same definition as for the dependency exemption—viz. a biological child, adopted child, step-child, or foster child, who resided with the taxpayer for more than six months during the calendar year, and is under age 19 at the end of the year or is under the age 24 and is a full-time student. Finally, a severely disabled child is a "qualifying child" regardless of age, even into adulthood, as long as the child continues to live with his or her parent(s). Note that a "qualifying child" for EITC does not have to meet the other requirements (i.e., support, gross income, joint return, citizenship) for a dependency exemption. EITC benefits are as high as \$4,824 for families with two or more qualifying children for 2008, although the average EITC is generally lower.

### Conclusion

The number of individuals with special needs is escalating at unprecedented rates in our society. Some experts argue that this may simply be a matter of better recognition of special needs. Whether due to under-reporting or not, these increased numbers are already beginning to affect state and local governmentally funded programs as they face shortfalls, forcing parents to absorb more of their children's medical care and other related expenses.

This article has summarized some of the more common deductions and credits that may be available under current tax law. However, parents of special needs children and their advisors should be aware that specific rules apply to each of these tax issues. For example, in order to claim the child's educational expenses, parents and practitioners must carefully examine the facts regarding medical expense deductions in facilities that are primarily educational and not special schools. Similarly, the deductions for medical conference expenses are very case specific. Even the generally available earned income credit has multiple requirements and limitations. In the end, it is important to understand the substantial tax benefits that are available to those caring for children with special needs.

*Thomas M. Brinker, Jr., LL.M., CPA, is a Professor of Accounting at Arcadia University in Glenside, Pennsylvania.*

*W. Richard Sherman, J.D., LL.M., CPA, is a Professor of Accounting at Saint Joseph's University in Philadelphia.*

*A more comprehensive discussion of the various tax benefits available for families with special needs children can be found in the November and December 2006 issues*

## Pennsylvania's Assault on Annuities Continues Post-DRA

Pennsylvania's assault on annuities continues, even into the post-DRA environment. The state Department of Public Welfare's (DPW) current policy is to allow a community spouse to purchase an annuity so long as the income it produces does not put the community spouse over the minimum maintenance needs allowance (MMMNA). It has tried several strategies to defeat annuities that provide income over this limit, without success so far.

Now, in a case involving a post-DRA annuity, DPW is arguing that new language in a section of the law dealing with the disclosure of interests in annuities overturns Medicaid's long-established distinction between income and resources. *Weatherbee v. Richman*, USDC Western District of PA Civil Action No. 07-00134.

Pennsylvania elder law attorney Jeffrey A. Marshall outlines the case and DPW's argument in his *Elder Care Law Alert* of Jan. 23, 2008. The wife of nursing home resident Theodore Weatherbee purchased a \$387,756 annuity on November 29, 2006. The annuity provided the wife with a payment stream of \$4,423.47 a month over 107 months. When Mr. Weatherbee applied for Medicaid, DPW determined that the payment stream from the annuity was an available resource because it could be sold on the secondary market for cash.

As Marshall explains, DPW is now pointing to 42 USC §1396p(e)(4) which provides: "Nothing in this subsection shall be construed as preventing a State from denying eligibility for medical assistance for an individual based on the income or resources derived from an annuity described in paragraph (1)."

According to DPW, this language allows it to count the income from the annuity as a resource.

Marshall points out that §1396r-5(a)(1), upon which DPW relies, "appears to be directly superseded by the community spouse income and resource provisions that it seeks to overturn. The income and resource provisions are contained in a different section of Medicaid law, 42 USC §1396r-5. And 42 USC §1396r-5 specifically states that it supersedes any other provision of Title 42 that is inconsistent with its provisions. 42 USC §1396r-5(a)(1)."

*of Exceptional Parent Magazine. This article was adapted from those articles and portions reprinted are with the expressed consent and approval of Exceptional Parent, a monthly magazine for parents and families of children with disabilities and special health care needs. Subscription cost is \$39.95 per year for 12 issues; Call (877) 372-7368. Offices at 416 Main Street, Johnstown, PA 15901.*