Individual Issues – Part 1

Issue 1: Health Care Deductions

Issue 2: Casualty Losses

Issue 3: Disaster Relief
Medical and Dental Expenses

Itemized deduction for expenses that exceed 7.5% of AGI

- 7.5% extended through December 31, 2020
1. Since the AGI floor for medical deductions has been reduced back to 7.5%, have you seen….

A. An increase in medical expense deductions
B. A decrease in medical expense deductions
C. No change in the amount of medical expense deductions
Definition of Medical Care

1. For the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body
2. For transportation primarily for and essential to medical care described in (1)
3. For qualified long-term care services
4. For insurance (including amounts paid as Medicare Part B premiums) covering medical care described in (1) or (2), or for any qualified long-term care insurance contract
Other Eligible Medical Expenses

- **Lodging**
  - Away from home for essential medical care
  - Medical care provided by physician in licensed hospital (or equivalent medical facility)
  - No significant element of personal pleasure
  - $50 per night per person maximum

- **Prescribed Drugs**
  Prescribed by physician or insulin
Capital Expenditures

- Eye glasses
- Seeing eye dog
- Artificial teeth & limbs
- Durable medical equipment – wheelchair, crutches, inclinator, or air conditioner detachable from property
- Permanent improvement or betterment of property to the extent it exceeds increased value of the related property
Example 9.2

- Cindy has heart disease
- Physician advises her to install elevator
- Cost of elevator = $20,000
- Increased value of residence = $10,000
- Deductible medical expense = $10,000 ($20,000 – 10,000)
Long-Term Care

- Diagnostic
- Preventive
- Therapeutic
- Curing
- Treating
- Mitigating
- Rehabilitative
- Maintenance or personal care

Required by a chronically ill person
Cost of inpatient care
- May include meals & lodging
- Based on Facts & circumstances

Example 9.3
- Patricia, 80 yrs old, moves to nursing home
- She is self-sufficient
- Nursing home gives her medication daily
Percentage method compares medical costs with total monthly costs

- Medical costs include:
  - Salaries of the medical center staff,
  - Incidental medication and supplies,
  - Percentage of amounts attributable to medical care for:
    - Housekeeping & Maintenance,
    - Utilities,
    - Administrative and marketing costs,
    - Interest on indebtedness,
    - Real estate taxes, and
    - Depreciation
Education Expenses

- Special school for a mentally or physically handicapped individual

- Cost include:
  - Meals & lodging
  - Ordinary education

- Cost of care and supervision or of treatment and training of a mentally or physically handicapped individual at an institution
At-Home Care Expenses

- I.R.C. § 262 – disallows a deduction for personal living & family expenses that are not medical

- *Estate of Marantz v. Commissioner*, Nursing type services by caregivers are medical

**Practitioner Note**

**Employment Taxes**

In Rev. Rul. 57-489, 1957-2 C.B. 207, the IRS ruled that the FICA tax paid on an expenditure that qualifies as a medical expense is also a deductible medical expense under section 213.
Qualified Long-Term Care Insurance Contract

1. Only insurance protection provided under contract is coverage of qualified LTC services
2. No pay or reimburse expenses incurred for services or items to the extent that such expenses are reimbursable under title 18 of Social Security Act
3. Guaranteed renewable
4. No cash surrender value or other money that can be paid, assigned, or pledged as collateral for loan, or borrowed, other than certain refunds
5. All refunds of premiums and dividends or similar amounts, under the contract reduce future premiums or increase future benefits
6. Consumer protection provisions
<table>
<thead>
<tr>
<th>Age Category</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 or less</td>
<td>$420</td>
<td>$420</td>
<td>$430</td>
</tr>
<tr>
<td>More than 40, less than 51</td>
<td>780</td>
<td>790</td>
<td>810</td>
</tr>
<tr>
<td>More than 50, less than 61</td>
<td>1,560</td>
<td>1,580</td>
<td>1,630</td>
</tr>
<tr>
<td>More than 60, less than 71</td>
<td>4,160</td>
<td>4,220</td>
<td>$4,350</td>
</tr>
<tr>
<td>More than 70</td>
<td>5,200</td>
<td>5,270</td>
<td>$5,430</td>
</tr>
<tr>
<td>Maximum excludable long-term care per diem</td>
<td>360</td>
<td>370</td>
<td>380</td>
</tr>
</tbody>
</table>
Medical & Dental Expenses of Dependent

- I.R.C. § 152 definition of dependent, with exceptions
  - Income > $4,300 is OK
  - Can be dependent of another
  - Can file jointly
Substantiation of Deductions

- Name & address of each person to whom payment for medical expenses was made
- Itemized Invoice or statement showing
  - Services rendered
  - For whom services were rendered
- The amount paid
- Date of the payment
Health Savings Accounts (HSAs)

- Pretax contribution
- High-deductible health plan (HDHP)
- No Medicare
- Not a dependent

PLANNING POINTER

Medicare Recipient

Taxpayers enrolled in Medicare cannot contribute to an HSA, but they can use HSA contributions made prior to age 65 to pay the premiums for Medicare Part B, Part D, and Medicare Advantage plans.
HSA Contributions

- Above-the-line deduction, up to limit
  - $3,550 self-only coverage
  - $7,100 family coverage
- Non-taxable fringe benefit if employer contributes
- Over age 55 = $1,000 additional
- Unused amounts can be used in later years
Distributions from HSA

- Used exclusively for qualified medical
- Non-medical expense, included in income + 20% added tax
  - Unless exceptions apply
High-Deductible Health Plan (HDHP)

- 2020 annual minimum deductibles:
  - $1,400 self-only
  - $2,800 family
- Safe Harbor allows no deductible for preventive care
- Notice 2019-45 expands list of preventive care
Flexible Spending Arrangements

- Employer-Sponsored
- Pre-tax Contribution
- $2,750 Medical Limit
- $5,000 Dependent Care Limit
COVID-19 Plan Relief

- HDHP can provide telehealth without deductible
- HDHP can provide COVID-19 testing & treatment without deductible
- HSA distributions for over-the-counter medication
2. Should medical deductions be an above the line deduction, capped at a specific dollar amount?

A. Yes
B. No
Casualty Losses

DEFINITION:

A sudden, unexpected, and unusual event that causes damage or destruction of property.
Personal Property Loss

- I.R.C. § 165(c)(3) – losses allowable if casualty or theft
- 2018 through 2025, federally declared disaster areas only
- Loss deduction = smaller of:
  - Property’s adjusted tax basis, OR
  - Decrease in FMV
- Reduce gross loss by insurance proceeds
  - Proceeds > loss, may have gain
Loss Deduction Limits

- REDUCE LOSS BY:
  - $100 for each separate casualty
  - 10% of taxpayer’s AGI (after $100 reduction) from SUM of all personal casualty losses

- Practitioner Note: Disaster Relief Act of 2019
  - $500 for each separate casualty
  - NO 10% AGI limitation
Losses Offset Gains

Personal casualty gains

- Offset by personal casualty losses (not Federal disaster) to extent it does not exceed the gain

- If both gain & loss in same year:
  - First reduce gain by loss not attributable to federal disaster
  - Then by losses attributable to federal disaster
### Examples 9.5, 9.6 & 9.7

<table>
<thead>
<tr>
<th></th>
<th>Example 9.5</th>
<th>Example 9.6</th>
<th>Example 9.7</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGI</td>
<td>$85,000</td>
<td>$85,000</td>
<td>$85,000</td>
</tr>
<tr>
<td>10% Limit</td>
<td>X 10%</td>
<td>X 10%</td>
<td>X 10%</td>
</tr>
<tr>
<td>10% of AGI</td>
<td>$8,500</td>
<td>$8,500</td>
<td>$8,500</td>
</tr>
<tr>
<td>Personal casualty loss</td>
<td>$10,000</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Personal casualty gain</td>
<td>0</td>
<td>$16,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>Personal casualty loss (fed)</td>
<td>0</td>
<td>0</td>
<td>$20,000</td>
</tr>
<tr>
<td>Allowable gain / (loss)</td>
<td>No loss</td>
<td>$6,100 (a)</td>
<td>($5,300) (b)</td>
</tr>
</tbody>
</table>

(a) $6,100 net gain = [$16,000 – ($10,000 – $100 per casualty)]
(b) $5,300 net loss = [($20,000 – $100) – $6,100 net casualty gain – $8,500 10% floor].
Costs Not Included in Personal Casualty Loss

- Cleaning up after a casualty
- Repairing or replacing damaged/destroyed property
- Temporary housing
- Rental car expenses
- Other incidental expenses
Proof of Loss

- The type of casualty (car accident, fire, storm, etc.) and when it occurred
- That the loss was a direct result of the casualty
- That the taxpayer owned the property (or, if the taxpayer leased the property, that the taxpayer was contractually liable to the owner for the damage)
- Whether there is a reasonable expectation of recovery from a claim for reimbursement
Calculating a Gain

- Insurance proceeds exceed adjusted basis
- Involuntary conversion rules can defer gain
  - Reinvest in similar or related use property
  - Replacement period:
    - 2 years after year of gain
    - 4 years for main home
Reporting Losses & Gains

- Form 4684, Section A

- If Loss:
  - Deemed to be an ordinary loss
  - Report on Form 1040, Schedule A

- If Gain:
  - Deemed to be a capital gain
  - Report on Form 1040, Schedule D
### FIGURE 9.3 Tornado Damaged Personal Property

<table>
<thead>
<tr>
<th>Item</th>
<th>Date Acquired</th>
<th>Adjusted Basis</th>
<th>FMV Before</th>
<th>FMV After</th>
<th>Difference in FMV</th>
<th>Insurance Payment</th>
<th>Gain or (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>House, land, and trees</td>
<td>2/01/2007</td>
<td>$287,000</td>
<td>$523,000</td>
<td>$235,000</td>
<td>$288,000</td>
<td>$257,000</td>
<td>$(30,000)$</td>
</tr>
<tr>
<td>Household items</td>
<td>Various</td>
<td>86,878</td>
<td>65,000</td>
<td>0</td>
<td>65,000</td>
<td>50,000</td>
<td>$(15,000)$</td>
</tr>
<tr>
<td>Coin collection</td>
<td>Various</td>
<td>3,546</td>
<td>6,000</td>
<td>0</td>
<td>6,000</td>
<td>6,000</td>
<td>2,454$</td>
</tr>
<tr>
<td>Anne’s car</td>
<td>7/19/2018</td>
<td>14,000</td>
<td>13,000</td>
<td>0</td>
<td>13,000</td>
<td>0</td>
<td>$(13,000)$</td>
</tr>
</tbody>
</table>

1. $257,000 insurance proceeds – $287,000 adjusted basis ($287,000 cost basis is less than the $288,000 reduction in FMV)
2. $50,000 insurance proceeds – $65,000 decrease in FMV ($65,000 decrease in FMV is less than the $86,878 adjusted basis)
3. $6,000 insurance proceeds – $3,546 adjusted basis ($3,546 adjusted basis is less than the $6,000 decrease in FMV)
4. $0 insurance proceeds – $13,000 decrease in FMV ($13,000 decrease in FMV is less than the $14,000 adjusted basis)
Temporary Living Expenses

- TP can exclude from gross income insurance reimbursements for the additional living expenses
- Exclusion = Actual living expenses incurred - household’s normal expenses
- Expenses include rent, meals, utilities, transportation, and misc. services
- Excess payments = taxable income
• Loss of business or income-producing property
• Not subject to $100 and 10% AGI limitations
• No federal disaster requirement
• Loss is:
  • Not totally destroyed: Smaller of decrease in FMV or adj. basis
  • If stolen or totally destroyed : Adj. basis
• Deduct incidental expenses
Deduction of Loss

- Form 4684, Section B
- Business property – transfer to Form 4797
- Investment – Form 1040, Schedule A
Deferral of Gain

- If reimbursement is similar to lost or stolen, no gain
- Basis in new property = adj. basis of replaced property
- Realizes & reports gain if money / unlike property rcvd
- But can defer gain by purchasing similar property
- Cost of replacement $\geq$ reimbursement amount
- Excess reimbursement included income
Replacement Property

- Specified to replace stolen or lost
- Cannot be gifted or inherited
- Can use borrowed funds
- Similar or related service/use (unless in federally declared disaster area)
- Basis in replacement property reduced by deferred gain
Loss of Inventory

Reporting Method 1:
- Record loss as increased COGS deduction
- Gross Income = insurance proceeds, sales, reimbursements
- Cannot claim casualty loss

Reporting Method 2:
- Deduct loss separately
- Form 4684
- Removes from COGS
- Form 4684 include reimbursements received
3. Has the number of casualty losses you have personally seen this year…

A. Increased
B. Decreased
C. Stayed the same
2020 Nationwide emergency declaration due to COVID-19
Disaster Relief Payments

- Grants
- Loan Cancellation
- Qualified Disaster Relief
- Qualified Disaster Mitigation
- Economic Impact Payment
Practitioner Note – Relief Programs

- Small Business Administration Programs
- Paycheck Protection (PPP)
- Economic Disaster Relief Loans (EIDL)
- EIDL Advance
Federal Loan Canceled

Under Disaster Relief Act:

▪ Debt forgiveness considered reimbursement for loss

▪ Cancellation reduces casualty loss deduction
Qualified Disaster Relief Payments

Payments for unreimbursed expenses (not included in income):
- Reasonable and necessary personal, family, living, or funeral expenses incurred as a result of the qualified disaster
- Reasonable and necessary expenses for repair or rehabilitation of a personal residence (rented or owned) attributable to the qualified disaster
- Reasonable and necessary expenses for repair or replacement of the contents of a personal residence attributable to the qualified disaster
- Includes payments to promote general welfare by federal, state, or local governments and for unreimbursed COVID-19 payments paid by an employer to an employee
Qualified Disaster Mitigation Payments

- Excludable from income
- Does not apply to amounts from sale or disposition
- Does not increase adjusted basis of property
Practitioner Note – Grants to Businesses

- NOT excludable for 2 reasons:
  - I.R.C. § 139 applies only to individuals
  - Payment not for general welfare

- I.R.C. § 1033 – defer gain realized by purchasing replacement property
Principle Residence in a Disaster Area

- No recognized gain – insurance for unscheduled personal property
- Other insurance for single item of property, similar or related in use
- Replacement period 4 years after end of year gain realized
GENERAL RULES

- 1 year for most affected by federally declared disaster area
- Abatement of interest & penalties
- If qualify write reason in margin of tax return, ex. “Texas Tornadoes”
COVID-19 Postponements

- July 15 return deadline
- Other time sensitive acts postponed
- Note – only federal, state deadlines may differ
Timing of Loss Deduction

- Year of Loss
- Preceding Year
- Elect prior year – 6 months after due date of return for disaster year
4. Should all of the Covid-19 relief programs be tax free?

A. Yes
B. No
Thank You!