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Long term care, medical, and dental expenses can add up to tax deduction

By Brian Thompson, Attorney at Law

Many elders have significant medical expenses, especially when long term care is involved. This article explains the itemized deductions for medical and dental expenses one may claim on Schedule A (Form 1040) with a focus on issues commonly faced by elders.

What are medical expenses?

Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments that affect any part or function of the body. Medical expenses include the costs of equipment, supplies, and diagnostic devices needed for these purposes. They also include dental expenses.

Deductible medical care expenses must be primarily to alleviate or prevent a physical or mental defect or illness. They do not include expenses that are merely beneficial to one's general health, such as vitamins or a vacation. Medical expenses include the premiums paid for insurance that covers the expenses of medical care and the amounts paid for transportation to get medical care. Medical expenses are also amounts paid for qualified long term care services, and limited amounts paid for any qualified long term care insurance contract.

What expenses may be included in the current year?

One may include only the medical and dental expenses paid in the current year, regardless of when those services were provided. Thus, if a person paid medical expenses by check, the day he or she mailed (or delivered) the check is the date of payment. If a person used a pay-by-phone or online account to pay medical expenses, the date reported on the statement of the financial institution showing when payment was made is the date of payment. If he or she used a credit card, medical expenses charged to the credit card are deductible in the year the charge is made, not when a person actually pays the amount charged.

A person may not include medical expenses that were paid by an insurance company or other sources. This is true whether the payments were made directly to him or her, to the patient, or to the provider of the medical services.

How much expenses is deductible?

A person may deduct only the amount of medical and dental expenses that is more than 7.5 percent of his or her adjusted gross income (Form 1040, line 38) I.R.C. § 213(a).

Example: Sally's adjusted gross income is $40,000. 7.5 percent of $40,000 is $3,000. Sally paid medical expenses of $2,500. She may not deduct any of her medical expenses because the expenses are not more than 7.5 percent of her adjusted gross income.

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Focus on taxes

Articles in this newsletter are informational only, and should not be construed as providing legal advice. For legal advice, please consult the author of the article or your own tax advisor.

Medical deductions

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Brian M. Thompson is a solo practitioner in Eugene. He is experienced in elder law; estate, gift, and income tax law; business succesion planning; and legal isues involving charitable giving and nonprofit corporations.

Whose medical expenses may be included?

Generally a taxpayer includes medical expenses paid for himself or herself as well as what he or she paid for someone who is a spouse or dependent. A taxpayer may claim medical expenses for a dependent only if that person was a dependent when the services were provided or when the taxpayer paid for the services. A person generally qualifies as a dependent for the purposes of the medical expense deduction if both of the following requirements are met:

- The person was a qualifying child or relative; and
- The person was a U.S. citizen or a national or resident of the United States, Canada, or Mexico.

A qualifying child is a son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or descendant of any of them (for example, a grandchild, niece, or nephew), and at the end of the current tax year was under the age of 19 or under the age of 24 and a full-time student, or permanently and totally disabled, lived with the taxpayer for more than half of the year, and did not provide more than half of his or her own support for the year.

A qualifying relative is a father, mother, or an ancestor or sibling of either, for whom the taxpayer provided more than half his or her support in the year.

What medical expenses may be included?

There are several types of medical expenses that may be included in a taxpayer's medical expenses for a tax year. Internal Revenue Service Publication 502 gives an alphabetical list of these. Note that each of these examples is subject to the 7.5 percent limit. Here are some of the highlights:

Capital expenses

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

Certain home improvements made to accommodate a person with a disability do not usually increase the value of the home, and the cost may be included as a full medical expense. These improvements include, but are not limited to, the following items:

- Constructing entrance or exit ramps
- Widening doorways at entrances or exits
- Widening or otherwise modifying hallways and interior doorways
- Installing railings, support bars or other modifications to bathrooms
- Lowering or modifying kitchen cabinets and equipment
- Moving or modifying electrical outlets and fixtures
- Installing porch lifts and other forms of lifts (but elevators generally add value to a home)
- Modifying fire alarms, smoke detectors, and other warning systems
- Modifying stairways
- Adding handrails or grab bars anywhere
- Modifying hardware on doors
- Modifying areas in front of entrance and exit doorways
- Grading the ground to provide access to the residence

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

*Example***:** Ralph has a heart ailment. On his doctor's advice, he installs an elevator in his home so that he will not have to climb stairs. The elevator costs $8,000. An appraisal shows that the elevator increases the value of his home by $4,400. He figures medical expenses as follows:

Amount paid for improvement:	$8,000
Minus increase in value to home:	- 4,400
Equals the actual medical expense:	$3,600

Amounts a taxpayer pays for operation and upkeep of a capital asset qualify as medical expenses as long the main reason for them is medical care. This rule applies even if none or part of the original cost of the capital asset is qualified as a medical expense. If, in the above example, the increase in value by installation

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of an elevator was $8,000, and the cost of the installation was $8,000, there would be no medical expense. However, the continued upkeep and maintenance of the elevator *is* a deductible medical expense

Automobile Example: A taxpayer may include in medical expenses the cost of special hand controls and other special equipment installed in the car for the use of a person with a disability.

Health insurance premiums

A taxpayer may include in medical expenses insurance premiums paid for policies that cover medical care. Policies may provide payments for hospitalization, surgical fees, prescriptions drugs, replacement of lost or damaged contact lenses, etc. In addition, qualified long term care insurance contracts may be deductible. However, the payroll tax paid for Medicare Part A is not a medical expense. Premiums paid for Medicare Part B are medical expenses, and Medicare Part D costs are also medical expenses.

Long term care

One may include in medical expenses amounts paid for qualified long term care services and premiums paid on qualified long term care contracts.

Qualified long term care services are necessary diagnostic, preventative, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal services that are required by a chronically ill individual and provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Maintenance or personal care services are those that have the primary purpose of providing a chronically ill individual with needed assistance with his or her disabilities.

The term *chronically ill individual* applies to an individual who, within the 12 preceding months, a licensed health care practitioner has certified as meeting either of the following:

- He or she is unable to perform at least two activities of daily living without substantial assistance from another individual for at least 90 days due to a loss of functional capacity. (Activities of daily living are eating, toileting, transferring, bathing, dressing and continence.)
- He or she requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

A *qualified long term care insurance contract* is an insurance contract that provides only coverage of qualified long term care services. The contract must:

- Be guaranteed renewable
- Not provide for cash surrender value or other money that could be paid, assigned, pledged, or borrowed
- Provide that refunds (other than refunds on the death of the insured or complete surrender or cancellation of the contract) and dividends under the contract, may only be used to reduce future premiums or increase future benefits, and not to pay or reimburse expenses incurred for medical services or items that would be reimbursed under Medicare except where Medicare is the secondary payer or the contract makes per diem or other periodic payments without regard to expenses

The amount of qualified long term care premiums the taxpayer may include on Schedule A of Form 1040 is limited. One may include the following as medical expenses:

- Qualified long term care premiums up to the amount shown below (Rev. Proc 2006-53)
  - *Age 40 or under, $290 per person per year*
  - *Age 41-50, $550 per person per year*
  - *Age 51-60, $1110 per person per year*
  - *Age 61-70, $2950 per person per year*
  - *Age 71 or over, $3680 per person per year*
- Unreimbursed expenses for qualified long term care services

Nursing home

One may include in medical expenses the cost of medical care in a nursing home, home for the aged, or similar institution, for one's self, one's spouse, or one's dependents. This includes the cost of meals and lodging in the home if the principal reason for being there is to get medical care. One may not include the cost of meals and lodging if the reason for being in the home is personal. One may, however, include medical expenses in the part of the cost that is for medical or nursing care.

Nursing services

One may include as medical expenses wages and other amounts paid for nursing services. The services need not be performed by a nurse as long as services are of a kind generally performed by a nurse. This includes

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One may include in medical expenses the cost of medical care in a nursing home, home for the aged, or similar institution, for one's self, one's spouse, or one's dependents.

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services connected with caring for the patient's condition such as giving medication or changing dressings as well as bathing and grooming the patient. These services can be provided in the patient's home or in another care facility.

Generally, only the amount spent for nursing services is a medical expense. If the attendant also provides personal and household services, amounts paid to the attendant must be divided between the time spent performing personal and household services and time spent for nursing services.

In-home care and employment taxes

One may include as a medical expense social security tax, FUTA, Medicare tax, and state unemployment taxes paid for a nurse, attendant, or other person who provides medical care. If the attendant also performs household and personal services, one may include as a medical expense only the amount of employment taxes paid for medical services. See IRS publication 926, *Household Employers Tax Guide*, for further information on the taxation of such persons.

What expenses may not be included?

Some normally incurred expenses cannot be deducted.

Ordinary babysitting and child care services

One may not include in medical expenses the amount paid for the care of children, even if the expenses allow the taxpayer or spouse to get medical or dental treatment. Of course, qualified long term care services for a chronically ill child may be included as medical expenses.

Controlled substances

One may not include in medical expenses the amount paid for controlled substances such as marijuana under the Oregon Medical Marijuana Act.

Health savings accounts

One may not include in medical expenses any payment or distribution for medical expenses out of a health savings account. See IRS Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans*

Medicines from other countries

One may not include in deductible medical expenses the cost of a prescribed drug brought in (or ordered or shipped) from another country, unless it was a drug that the FDA says may be legally imported by individuals. One may include the cost of a prescribed drug purchased and consumed in another country if the drug is legal both in the other country and in the United States.

Sale of Medical Equipment or Property

If a taxpayer deducts the cost of medical equipment or property in one year and sells it in a later year, he or she may have a taxable gain. The taxable gain is the amount of the selling price that is more than the adjusted basis of the equipment or property. The adjusted basis is the portion of the cost of the equipment or property that one could not deduct because of the 7.5 percent limit used to compute medical deductions. In order to compute this, see worksheet D to the Form 1040.

In conclusion

As you can see, the rules that deal with medical expenses are complicated. If you have further questions, IRS Publication 502, *Medical and Dental Expenses*, is the best place to start. In addition, remember that all expenses that are listed as deductible are still subject to the 7.5 percent limit. ■

A look at basic tax issues in connection with gifts

By Susan Daigle, Attorney at Law

If a person gives someone else money or property, the gift giver may be subject to federal gift tax. The money and property one owns at the time of death (one's estate) may be subject to federal estate tax.[1] The purpose of this article is to give a general understanding of the federal gift tax, when it applies, and how it interacts with the estate tax.

Gift definition

A gift is the voluntary transfer of property or funds to another without receiving anything of value in return and without conditions attached while both the giver and the recipient are still alive. The gift giver (*donor*) must understand the nature of the act and have a voluntary intent to make a gift (*donative intent*). There must be either physical or symbolic delivery of the gift and actual or imputed acceptance by the recipient. If a person sells something at less than its full value or if he or she makes an interest-free or reduced interest loan, that person may have made a gift.

Annual exclusion

An annual gift tax exclusion permits someone to give up to $12,000 per year (in tax years 2006-08) in cash or assets to each of an unlimited number of people without incurring gift tax liability. IRC §2503(b)(1).

By combining their exemptions, married couples can give up to $24,000 per year as a gift to as many people as they want—a "split gift." This can be advantageous for gifts made in anticipation of a spouse's death because these gifts are not added back into the estate (with the exception of life insurance given within three years of one's death.) See IRC §2035. The spouses must both be citizens or U.S. residents. IRC §2513(a)(1).

Gifts that are eligible for the annual $12,000 exclusion apply only to gifts of present interest, meaning that the receiver can enjoy and use the property and income now. IRC 2503(b)(1). Gifts of future interests—meaning the receiver's use of the property will not begin until some future date—do not qualify.

Lifetime exclusion

A gift in excess of the $12,000 annual exclusion is considered a "taxable gift." One is allowed to give up to $1,000,000 in property during one's lifetime tax-free. This "applicable exclusion amount" corresponds to a unified credit of $345,800 through 2009. IRC §2505(c). If one makes a taxable gift in any given year, the amount of gift tax generated by the excess must be applied against one's lifetime credit. The donor must also file a Form 709.

The federal gift and estate tax rates are combined into a single rate schedule. Therefore, the tax owed on a taxable gift will be the same as the tax applied to the estate. To the extent that the unified credit is not used up during one's lifetime to offset gift taxes otherwise payable, it will be used to offset estate taxes payable. See also IRS Pub. 950. Of course, any gift of any size transferred between spouses (where both are U.S. citizens) is 100% gift-tax-free because of the marital deduction. IRC §2055.

Exclusion for medical bills or tuition expenses

In addition to the $12,000-per-recipient annual gift tax exclusion, there is an exclusion for direct payments to a third party for medical expenses or education tuition expenses. IRC §2503(e). Both the medical and educational exclusions are allowed without regard to the relationship—so the recipient need not be a close relative or a dependent. Payments made directly to the recipient do not qualify for the tax benefit.

Medical care includes expenses for diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, or for transportation. It also includes medical insurance. 26 CFR 25.2503-6(b)(3).

A qualifying educational organization is one that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students. 26 CFR 25.2503-6(b)(2). Room and board, supplies, books and other fees do not qualify.

Exclusion for charitable gifts and the charitable gift annuity

Gifts to a qualified charity, regardless of the amount, also do not get applied against the lifetime gift exclusion. IRC §2522. Many people choose to make charitable gifts as part of a charitable gift annuity (CGA). With this strategy, the donor is able to make a gift to a philanthropy, receive regular fixed payments for life, and enjoy tax benefits. The gift is considered a lifetime gift. The important thing to remember is that the gift is irreversible and can never be retrieved from the charity even if the charity goes bankrupt or there is a personal emergency.

The annuity payments are tax-free partial returns of the donor's gift based on actuarial tables of life expectancy. The older the donor, the higher the annuity payment the donor can lock in. These rates are generally lower than what a person could receive by purchasing a commercial annuity, but the tax deduction partially offsets that. Furthermore, compared to commercial annuities, CGAs are relatively straightforward.

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Resources

Gift tax law: ***http://law.freeadvice.com/tax***

Retirement Planning: "Charitable Gift Annuities: When You Can Give and Receive." National Endowment for Financial Education (2005) ***www.aarp.org/money/financial_planning/sessionseven/charitable_gift_annuities.html***

Federal Estate Tax; Generation-Skipping Transfer Tax: "Administering Oregon Estates" (OSB CLE 2002)

Information relevant to Washington State: ***www.avoid-probate.com***

Additional pros and cons of CGAs:

- The gift annuity payments are fixed. They will never go down, but they will never go up either, so there is no inflation protection.
- CGAs are not insured like most bank accounts and investments. A charity can become insolvent and be unable to make annuity payments. It is important to research the organization that one is interested in donating to, including its short-term and long-term financial situation.
- Donors can give assets to a charity that have grown in value, but which produce little income. In addition to receiving annuity payments, donors have reduced the size of their estates.

Property in joint ownership with right of survivorship may be a gift

The majority of persons putting property into joint tenancy for estate planning purposes want to add their children's names to the title so that the property will pass to their children without probate. In intent, they want to make a gift that takes effect when they die (like creating a POD bank account).

In fact, by adding someone else's name to the title in joint tenancy, the property owner is making a gift that takes effect immediately. The person whose name is added becomes a co-owner of the property at the time of the transfer. If the value of the interest transferred exceeds the gift tax annual exclusion amount, the transfer will be a taxable gift, and if it exceeds the gift tax applicable exclusion amount, a gift tax will be due.

Other disadvantages of joint ownership:

- *Reduces one's estate.* Making a gift by putting property into joint tenancy form with one or more other persons will reduce the transferor's estate. However, if his or her financial situation changes for the worse in the future, the transferor may be unable to reacquire the property if and when he or she needs it.
- *Possible transfer by the transferee.* The new co-owner now has the right to sell or mortgage his or her interest in the property, without the original owner's consent. Even if the original owner severs the joint tenancy, it will not return the gift to him or her. It will only prevent his or her share of the joint tenancy from passing to the other person.
- *Possible involuntary loss (judgment creditors).* Property held in joint tenancy can be attached in favor of its owner's creditors. A person could lose a lawsuit and the prevailing party could attach his or her joint tenancy interest in satisfaction of the judgment.
- *Possible later transfers inconsistent with transferor's and transferees' estate plans (unintended disinheritance).* In the case of multiple co-owners, each one will likely want his or her joint tenancy interest to pass to his or her heirs—not to the other co-owners. However, if a person predeceases the other co-owners, they—not the deceased peson's heirs—will inherit the interest in the property.
- *Possible unnecessary increase to recipient's taxable estate or estate tax payable***.** If any of the recipient joint tenants predecease the donor, the value of that recipient's joint tenancy interest will increase the value of his or her gross estate for estate tax purposes.
- *Loss of step-up in basis and possible increase in income tax payable upon sale***.** At the time of the creation of the joint tenancy, each of the recipients will take a carry-over basis in his or her share of the property for income tax purposes. Assuming that the property appreciates from the time of the creation of the joint tenancy until the time of the donor's death, the surviving joint tenants may lose the step-up in basis that they would otherwise have received had they received their interest as a result of the donor's death. ■

1 Although bequests may also be subject to an additional tax—the generation-skipping transfer tax (GST)—if the gifts are to a person, such as a grandchild, who is more than one generation younger than the donor, this tax is not discussed here.

Susan Daigle is an attorney with Cavanaugh Levy LLP.

Programs to defer property taxes and delay tax foreclosure benefit lower-income citizens

By Leslie Kay, Regional Director, Legal Aid Services of Oregon, Multnomah County Office

Two programs in Oregon allow people over age 62 and persons with disabilities to delay the payment of property taxes on their residences. If a citizen qualifies for one of the deferral programs, the state pays the property taxes to the county. A lien is placed on the property and the deferral accounts accrue six percent simple interest each year. Lien fees and interest are also deferred. The property tax lien has the same priority as other tax liens but follows any mortgages, security interests, or trust deeds that are recorded prior in time to the property tax lien. ORS 311.673. Deferral is available even if delinquent taxes are owed. Application for a ***delay of foreclosure*** after approval for a deferral program will remove property from a county's foreclosure listing while it is on the deferral program.

To be eligible for the senior citizens' property tax deferral, one spouse must be age 62 or older or non-spousal joint owners both must be 62 on or before April 15 of the year a claim is filed.

To be eligible for disabled citizens' property tax deferral, one must be eligible to receive or be receiving federal Social Security disability benefits before April 15 of the year one files the claim. Only one joint property owner needs to qualify as an individual with disabilities.

Income limits apply

For both programs, household income must be less than the federal adjusted gross income (FAGI) limit. The FAGI limit for income tax year 2006 is $36,500. This limit may change each year. If income exceeds the FAGI limit after a deferral account is established, one may be responsible for all or part of property tax liability for that year. The deferral amount will be reduced by 50 cents for each dollar over the FAGI limit.

Married couples and joint owners must own or be purchasing the fee simple estate and live on the property unless there are medical reasons for not doing so. OAR 150-311.668 (1)(a)-(A) and (B). A medical statement on letterhead from an applicant's health care provider must be mailed to the Oregon Department of Revenue if a medical exemption is sought.

Manufactured homes, houseboats, multi-family homes, and income-producing properties are potentially eligible for the programs. There must be no prohibition to the deferral of property taxes contained in any provision of federal law, rule, or regulation applicable to a mortgage, trust deed, or land sale contract for which the property is security.

Application process

To apply for the programs, one must obtain a deferral application booklet from a county assessor's office or the Department of Revenue's Web site at **http://egov.oregon.gov/DOR/PTD/IC_490_675.shtml.** The application must be filed between January 1 and April 15. To complete the application one will need to attach the following documents:

- a copy of the property deed
- a copy of the property tax statement or printout from the previous year
- an income worksheet
- a copy of one's federal income tax return from the previous year
- a copy of title, if the property is a mobile home
- a copy of a trust if the property is in trust, a power of attorney if an attorney in fact is applying for the deferral
- a copy of a doctor's statement if one does not live on the property because of medical reasons
- a copy of the federal Social Security award letter if one is applying for the disabled citizens' property tax deferral

A person needs to apply only once for the deferral, not every year. If a spouse dies, however, the surviving spouse may be required to reapply under certain conditions. See ORS 311.688.

Payment of deferred taxes

When the deferral property is inherited and the heir makes the property his or her principal residence by August 15 of the following year, a repayment schedule may be arranged with the Oregon Department of Revenue. ORS 311.695.

One may pay all or part of the deferral account and continue to defer current and future taxes. Relatives or friends may also make payments on an account if the deferral holder does not object. Payments are applied first to lien fees, then accrued interest, then to past deferred taxes. ORS 311.690.

Delay of foreclosure

The deferral programs pay only the current and future years of property taxes to the county. The deferral programs do not pay any delinquent property taxes or the interest one may owe to the county. After the Oregon Department of Revenue approves an application for property tax deferral, one may apply to the county for the delay of foreclosure if there are delinquent taxes. See ORS 311.693 and the Department of Revenue Web site **www.oregon.gov/DOR/PTD/docs/490-017fill.pdf** for an application form. The county assessor will approve or deny the application. If the application is denied, the owner may appeal to the circuit court in the county where the tax-deferred homestead property is located. Manufactured structures and floating homes that are not real property *do not* qualify for delay of foreclosure.

For further information contact the Department of Revenue Deferral Unit in Salem at 503.378.4988 or 800.356.4222 or Deferral.unit@state.or.us. ■

An overview of IRAs and their tax ramifications

By Brian Haggerty, Attorney at Law

Brian Haggerty's practice focuses on estate planning and elder law. Prior to earning his J.D., Brian was a tax consultant for 12 years. His practice is in Newport, Oregon.

The purpose of this article is to suggest some practical approaches to helping elders plan with Individual Retirement Accounts (IRAs). It presents some ideas and awareness issues—but not all the rules for contributions and distributions from IRAs. I will not qualify every sentence with "in general," but you should keep in mind that there is at least one exception and a special case applicable to every statement that can be made about IRAs.

A personal opinion: When helping a client with IRAs, and indeed with all tax issues, it is a good idea to involve the client's CPA or tax consultant in your discussion. For starters, two heads are better than one. Also, two errors-and-omissions liability policies are better than one. And your clients' tax return preparer is going to have to sign their tax return, so it's only fair to discuss tax matters up front.

In addition, all tax issues are intensely fact-driven. What is good advice for one client may not make sense at all for his neighbor, who may appear to be similarly situated. The tax-return preparer has a great deal of specific information from past years, not all of which appears on the face of the returns. Finally, your local accountants can be a good referral source for you, if you establish that you respect what they do and are capable of working with them.

Information gathering is critical at the outset of any discussion about IRAs. It is important to find out first if the account is in fact an IRA as opposed to a 401(k) or 403(b) or other qualifying pension plan. The client may not be reliable on this point, and in fact may be referring to an account by some marketing terminology invented by his bank or broker.

Also, you need to know whether the account is a "traditional" IRA, a Roth IRA, an "education IRA," a SIMPLE plan, or a SEP-IRA. Although clients refer to many different kinds of accounts as "IRAs," there are strikingly different rules for different plans.

If you will be doing any specific tax planning for your client, you will need to know when the account was set up, whether there have been any nondeductible contributions, and whether any previous distributions have been taken from the plan. A copy of the plan agreement may be needed.

"Traditional" IRAs and Roth IRAs

The two basic kinds of IRAs are "traditional" and Roth IRAs. With traditional IRAs, contributions are deductible from gross income on the owner's tax return, earnings grow tax free, and all distributions are taxable. With the Roth IRA, contributions are not deductible, earnings grow tax free, and distributions are not taxable.

Contributions may be made to traditional and Roth IRAs in the same year, and the same limits apply to all such contributions. A taxpayer must have compensation from work (wages, salary, commissions, or self-employment income) or alimony to contribute to an IRA. Contributions are limited to the lesser of $4,000 a year ($5,000 a year for a taxpayer age 50 or over) or the compensation. These limits are reduced for high-income taxpayers.

An important distinction between traditional IRAs and Roth IRAs is that a taxpayer must begin withdrawing a minimum amount out of a traditional IRA each year after the taxpayer turns 70 ½ years old. There are no minimum required distributions from Roth IRAs.

Traditional IRAs may be converted to Roth IRAs by taxpayers with adjusted gross income of $100,000.00 or less. In 2010, this conversion opportunity will open up, and anyone will be able to convert his or her IRAs to Roth IRAs. Even though the IRS refers to this as a "rollover," income tax has to be paid on the whole amount converted, unless the taxpayer has made nondeductible contributions to the IRA. Every taxpayer with IRAs should consider this conversion option, because the freedom from taxation on distributions, and no required distributions, may offer substantial advantages. However, the amount of tax that will be incurred on conversion has to be accurately estimated, and this tax will make conversion impractical or disadvantageous for many.

In terms of resources that an elder client may hold, the Roth IRA will be easier to work with. If an elder needs to start using funds from a traditional IRA, there will be a tax load on every distribution. If the amounts needed are large enough, they may cause some of the elder's Social Security to be taxable.

There may be special circumstances that will make it advantageous for a particular elder to

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IRAs

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continue to make contributions to a traditional or Roth IRA. Contributions to a Roth IRA can be made regardless of age, as long as the taxpayer or spouse has compensation. Contributions may not be made to a traditional IRA after the taxpayer has reached 70 ½.

However, for most elder clients, you will not be considering contributions to IRAs, but rather distributions.

Distributions

As stated above, all distributions from traditional IRAs are fully taxable, unless the taxpayer has made nondeductible contributions to the IRA, in which case a pro-rata portion of each distribution is not taxed. The taxpayer has the burden of providing that there have been nondeductible contributions, and should have filed Form 8606 with prior years' tax returns.

Prior to age 59 ½, distributions from a traditional IRA will also incur a penalty of 10% of the distribution, in addition to the income tax. There are a slew of relatively narrow exceptions to the early distribution penalty, such as for disability, certain medical expenses, certain educational expenses, or purchasing a first home. Each exception has specific requirements, and care must be taken to meet all of them. Taxpayers who inherit someone else's IRA—although required to take distributions even if they are younger than 59 ½—do not incur the 10% penalty.

Because distributions are taxable, clients tend not to touch IRAs, sometimes until they have consumed all their other resources. This default approach may not be appropriate for many of your clients. You may encounter a client whose assets to a very large degree consist only of retirement accounts and a house. Encourage this client to consult his or her tax adviser about whether it might be wise to begin taking distributions from the IRAs prior to age 70 ½. Depending on the client's other income, this approach may be less expensive in the long run, and it avoids the problems that arise if IRAs are included in a decedent's estate.

Clients with large amounts in traditional IRAs may also want to look into a charitable remainder trust or other charitable giving strategy, which may result in substantial tax savings.

After the owner of a traditional IRA reaches age 70 ½ he or she must begin taking required minimum distributions (RMDs). (Incidentally, clients sometimes say their IRAs are jointly owned. They're not. An IRA is always owned by one individual.) The RMD is the amount that must be taken out of the account annually so that the account will be fully distributed over the taxpayer's expected lifetime. The annual RMD is figured separately on each of the taxpayer's IRAs, but the total amount may be taken out of just one IRA, so the taxpayer can hold onto better-performing investments and take the aggregate RMD out of IRAs that aren't doing as well. Penalties apply if the correct RMDs do not begin on time, or if the correct RMD is not distributed each year. The RMDs are taxable, just as any distribution is taxable.

The Pension Protection Act of 2006 provided a narrow window for taxpayers with charitable intent to avoid paying tax on their RMD. Known as a "charitable rollover," the strategy is only available for 2006 and 2007, and specific requirements apply.

Distributions may be taken tax free from a Roth IRA at any time after the taxpayer reaches age 59 ½. Prior to 59 ½, the 10% early distribution penalty may apply, with exceptions as described above. If distributions are taken from a Roth IRA less than five years after it was converted from a traditional IRA, the early distribution penalty may apply.

Inherited IRAs

IRAs should always be considered separately in the estate plan. IRAs will transfer on the owner's death according to beneficiary designations, and it is advantageous to name individuals as beneficiaries, as discussed below. It is not advantageous for an IRA to be payable to the estate of the owner, and you should not transfer an IRA to a revocable living trust unless you are completely certain the terms of the trust will not run afoul of any of the rules concerning distributions or prohibited transactions with IRAs.

This means that the estate planner should remind clients to verify the named as beneficiaries for the IRA. Do not let the client rely on his or her recollection or guess as to who is named. Make sure that contingent beneficiaries are named, as well as a primary beneficiary. The pattern of beneficiaries for non-probate transfers should match or complement the pattern of distributions in the will or trust. If changes are being made to the will or trust, make sure that corresponding changes are made to beneficiary designations. If you overlook this, you may find yourself explaining to the children, for example, why the despised former wife and stepmother gets 100% of the hefty IRA.

A trust that is properly structured can be named as beneficiary of an IRA, and the IRA will "see through" the trust and treat the trust beneficiaries as beneficiaries of the IRA. This is significant because the beneficiaries can then take distributions based on their own life expectancies, allowing them to spread the taxable distributions over a span of years. The trust may be inter vivos or testamentary, must be irrevocable, and the beneficiaries of the trust must be identifiable. The IRA custodian must be provided relevant information about the trust by October 31 of the year following the year of the owner's death, and other requirements apply. If a trust is the beneficiary of an IRA, it would probably be well to make the IRA payble to a separate qualifying trust, rather than trying to make a credit shelter trust or another standard vehicle into a trust that qualifies to receive IRA proceeds.

Only a spouse of the deceased IRA owner may treat the IRA as his or her own IRA, or roll the IRA over into his or her own IRA. A spouse may also continue to treat the IRA as an IRA, and make contributions to it.

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IRAs

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A beneficiary other than the surviving spouse has to begin taking RMDs from the IRA. If the IRA owner died after age 70 ½, such a beneficiary has to take RMDs based on the longer of the beneficiary's life expectancy under IRS tables or the deceased owner's life expectancy based on the tables. If the IRA owner died before age 70 ½, the beneficiary can take distributions based on his or her own life expectancy. If the beneficiary is not an individual, e.g., the decedent's estate or a trust that does not qualify, the entire IRA account balance must be taken out within five years.

The IRS uses the unfortunate terminology "inherited IRA" to refer to the IRA account after the owner's death. This may confuse clients, but the lawyer should be clear that the inherited IRA doesn't act like an IRA— the beneficiary (other than a spouse) cannot contribute to it, cannot roll it over into other IRAs, and must take distributions from it.

Under new rules beginning in 2007, a decedent's IRA or other qualified retirement plan can be "rolled over" into an "inherited IRA." Although this allows the non-spouse beneficiary to move the IRA assets to a new custodian without incurring tax, the new account will still be subject to the RMD rules, and will not be like the beneficiary's own IRAs.

Prohibited Transactions

There are many ways to mess up with IRAs, and there are penalties for some kinds of mistakes. For other mistakes, the taxpayer may simply have to pay tax, and in some cases, an improper transaction with an IRA may cause the account to stop being an IRA, with resulting tax adjustments and penalties that may affect more than one tax year. IRAs can't make loans, be pledged as collateral for loans, or own certain kinds of assets. The owner and family members can't sell property to it or receive compensation for managing it. One can't contribute too much to it, or distribute too little.

Planning with IRAs

Thanks for reading this far. Despite the wonderful density of this article, I have only skimmed the rules concerning IRAs. For the elder lawyer and estate planner, IRAs will always constitute the "special case," and will need to be considered separately in planning.

For example, consider a married couple, one of whom needs residential care ("Ill Spouse"). They own a home, but have very little cash, other than a substantial amount in Ill Spouse's IRA. For Medicaid purposes, an asset transfer to Well Spouse is part of the planning process to establish the community spouse resource allowance. If funds are needed from the IRA, the transfer will be a taxable distribution unless a support order is obtained from a court. Depending on the specific numbers involved, it may be just as efficient to pay tax, if a spend-down will occur anyway. It may be possible to pay for care privately, using funds from the IRA, while saving other funds for Well Spouse, because the cost of residential care is deductible, as long as it is medically necessary.

For the estate planner, the client with substantial amounts tied up in retirement plans presents a problem. The theory behind IRAs is that the taxpayer gets deductions and tax-free growth during years when his or her earnings (and tax rates) are high, and then takes distributions when income (and the tax rate) is lower. However, as noted above, the disinclination to pay tax remains strong, and clients may tend to resist taking distributions from the IRA, even though their other income is quite limited and their tax rate very low. If the client dies owning an IRA, it may pass to beneficiaries who are themselves at the peak of their earning years, and the distributions will be taxed at very high rates.

In some situations, it may be better to begin taking distributions before they become required when the owner reaches 70 ½. Or there may be opportunities to convert traditional IRAs to Roth IRAs. (A portion of the IRA account may be converted, if converting the whole IRA would result in too much tax.) Finally, for some clients, a charitable transfer of the IRA in exchange for an annuity may be an appropriate option. In each case, if the lawyer is not an experienced tax-return preparer, it will be best to work with the client's accountant and project estimated amounts of tax for each scenario.

It is important to keep in mind that there are different kinds of IRAs, and clients often may not be clear on exactly which they have, and how tax attributes have been affected by decisions made in prior years. Worse, even bank and brokerage professionals may be incautious about the terminology they use to refer to these accounts. It is worth making sure you have specific information before recommending strategies.

Oh, and remember: the rules are likely to change in the next year or so.

In conclusion

Unfortunately, the basic assumptions behind IRAs cause taxpayers to wait and leave these assets untouched for as long as possible. Frankly, financial advice is often driven by the concerns of high-bracket taxpayers and may not be appropriate for many of your clients. In the course of estate planning, you may encounter a client whose assets to a very large degree consist only of retirement accounts and a residence. Encourage this client to consult his or her tax advisor on whether it might be wise to begin taking distributions from the IRAs prior to age 70 ½. Depending on the client's other income, this approach may be less expensive in the long run and may avoid some of the problems described above. ■

Spousal Pay Program helps couples

By Genevieve M. Sundet, Manager, Medicaid Program Unit, Seniors and People with Disabilities

Oregon has a Medicaid program that provides financial assistance to spouses who provide in-home care. The Spousal Pay Program is one of the options available under the In-Home Services Program administered by the Oregon Department of Human Service, Seniors and People with Disabilities Division (SPD). SPD recognizes that a person who receives care from a relative is likely to experience a higher comfort level, especially when receiving personal care services, and is more confident that his or her care needs will be met. The related homecare worker is likley to be committed to providing quality care.

The Medicaid 1915(c) waiver prohibited using federal funds to reimburse a spouse for the provision of care, so the Spousal Pay Program was originally funded with state general funds. Each legislative session, the program came under scrutiny because of the funding source and lack of federal matching dollars. Because of a need to reduce the state budget, the 1999 Oregon Legislature directed SPD to seek a way to pay spousal providers through a Medicaid program. In a move to avoid closing the program entirely, the 2000 Legislature authorized funding, but only for those in the program at that time — in essence, setting a cap on the program of 180 clients.

In its 2006 1915(c) Home and Community-Based Services waiver renewal, SPD submitted a request to included spousal providers. The request was approved and the Spousal Pay Program is now another waivered service option under the Home and Community-Based Services Waiver.

Eligibility requirements and services provided in the Spousal Pay Program do differ from the traditional in-home services program. To be eligible, the individual who requests services must meet the following conditions:

- Require "full assistance" in at least four out of six activities of daily living; i.e., eating, dressing/grooming, bathing/personal hygiene, mobility (ambulation and transfer), elimination (toileting, bowel and bladder management), or cognition/behavior, as defined in OAR 411-015-0006 Activities of Daily Living (ADL)
- Be eligible for Medicaid Home and Community-Based Waivered Services (with an income limit of 300% of SSI per individual or an income cap trust)
- Otherwise require nursing facility services without in-home services
- Have a medically diagnosed, progressive, debilitating condition or have a spinal cord injury or similar disability with a permanent impairment
- Have service needs that exceed the usual and customary services provided by one spouse to another

Additionally:

- The individual must be legally married to the provider; and
- The spouse must meet all qualifications for enrollment as a homecare worker through SPD—including a criminal-history check.

The spouse has to be able to meet the individual's care needs. She or he must have the health and ability to perform duties such as bathing or dressing the individual. These duties may include lifting or carrying the individual. In order to be compensated for these tasks, the spouse must be the principal care provider.

Both the individual and spouse benefit in many ways from this program. The spouse is able to stay at home and provide care without losing needed income. Spousal pay providers are live-in homecare workers covered by a union contract with SEIU Local 503, OPEU. As homecare workers, they have access to certain benefits. All homecare workers for elders and people with physical disabilities enrolled through SPD are eligible for the following benefits, regardless of how many hours they work:

- Workers' Compensation coverage
- Income tax withholding
- Unemployment insurance
- FICA/Medicare tax withholding
- Direct deposit of paychecks—voluntary electronic deposits

Depending on the number of authorized service hours provided, the homecare worker may also receive paid leave and health insurance. ■

NOTE:

Now that the Spousal Pay Program is included in Oregon's Title XIX Home and Community Based Services waiver, it is possible for a Medicaid client to divert a portion of his or her income to a spouse (aka, spousal diversion).

This would decrease any amount the client may need to pay toward the cost of services. The spousal provider's income from the Department of Human Services would be considered in calculating how much income could be diverted.

New Developments in Elder Law

By Cynthia L. Barrett, Attorney at Law

This is the fourth in a series of columns by Cynthia L. Barrett that highlight trends in the practice of elder law, both locally and nationally, and direct the practitioner to helpful resources, including recent cases, administrative rules, and Web sites.

Website alerts

Elder law and estate planning practitioners around the country are buzzing about the elder abuse Web site, **www.stealanestate.com**, debating whether it teaches someone how to engage in financial abuse, or will educate families to prevent it. What do you think?

Tennessee practitioner Tim Takacs's Life Care Plan seminars continue to attract a lot of buzz around the country. No Oregon lawyer has yet adopted his model. Check out his Web site at **www.tn-elderlaw.com** for education seminars and program outlines. Washington lawyer Rajiv Nagaich, **www.eldercounselor.com**, has adopted the program, and is actively promoting the life plan practice model.

Protective Services financial exploitation flow chart published

Wonder if your mental health or developmental disability case involves financial exploitation? Oregon's Senior and People with Disabilities (SPD) Division issued a flow chart that highlights the facts that will trigger a protective service investigation or criminal prosecution. See SPD IM 07 009 (Feb. 13, 2007) on the SPD policy Web site at **www.dhs.state.or.us/policy/spd/transmit/im2007.htm.** Note that developmental disability and mental health clients who receive county and brokerage services do not get an immediate protective services investigation. Note also that having a facility's staff member witness a client's will is sufficient to trigger protective service involvement.

Fewer petitions to increase CSRA; more petitions to transfer followed by protection

State Medicaid agency restrictions on use of court petitions to increase the community spouse resource allowance have reduced the number of such petitions filed. Attorneys are migrating to a two-step process:

Step 1: Establish a conservatorship petition to make exempt transfers, with notice to the state.

Step 2: After the assets are transferred, engage in spousal asset protection using annuities and smart spend-down techniques.

DRA-compliant promissory notes

Some clients are making gifts to children of part of their assets, and a loan of another portion of the assets with a DRA-compliant promissory note, providing payback to the parents sufficient to pay for care during a disqualification period. This technique holds promise as a "fix-it technique" when prior disqualifying transfers were made, because it is crucial to make the applicant "otherwise eligible" for care to start the disqualification period running.

Attorney fee request cut 90% in contested guardianship

In a recent Multnomah County conservator/guardian case, Judge Susan Svetkey awarded $15,000 in lawyer fees for an interested party (the daughter of the protected person) rather than the $151,674.92 she sought. An elderly Portland businessman with $6,000,000 in assets began to decline. His wife also declined and died. He had one daughter from an earlier marriage, and a long-time woman friend. His niece filed a petition for appointment of the man's business lawyer (and attorney in fact) as conservator. The declining elder and his daughter both objected, and the daughter filed a cross-petition for appointment as fiduciary.

The elder's financial affairs were managed by his business lawyer—an agent under power of attorney—and a secretary. Both his daughter and his girlfriend had a series of disputes with them. The elder suspected others of financial misdeeds and chicanery. Issues included: (1) allegations of elder abuse by his estate planning lawyers, financial manager, and the girlfriend; (2) whether the conservator should elect against the deceased wife's will; and (3) whether a $200,000 gift to the daughter was void.

The case was resolved after a brief hearing by appointment of an independent conservator charged to conduct an investigation of the various claims and report to the court. Interested parties filed for attorney fees. Both the independent conservator and the business lawyer objected to the daughter's request for $151,674.92 in lawyer fees.

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New developments

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The judge issued a three-page letter opinion allowing only ten percent of the requested fees and costs.

Relying on ORS 125.095 (there being, as the judge pointed out, no Oregon appellate authority on the matter), the judge allowed the daughter's lawyer fees only for work related to the protective proceeding, not efforts to investigate the elder's property dealings. In determining the reasonableness of the fees, the judge deferred to expert testimony by attorney Wes Fitzwater that a reasonable fee was between $7,000 and $15,000 to obtain appointment of a fiduciary. The judge noted:

> Significantly, [the daughter] sought the assistance of an attorney because she was concerned about her fathers [sic] health and safety, not due to concern about his property. Significantly, no steps were taken by her attorney to investigate his health and safety, but rather all efforts were devoted to issues involving his property.

In the conservatorship case, the daughter generated much heat with allegations that others in the orbit of the declining elder (financial manager, secretary, deceased wife, girlfriend, estate planning lawyers) were trying to interfere with her father's relationship with her, and divert her inheritance. The court found that legal work done on the daughter's behalf without apparent benefit to her father was not to be charged to the elder's funds.

While this ruling is only at the trial court level, and appellate guidance is lacking, attorneys for interested parties should take note. Frame the pleadings and all arguments in the protective proceeding to cover issues *relevant to the protected person's welfare*, and if the client's self interest must be mentioned, link it with something that affects the protected person's welfare. Warn the interested person that efforts aimed at a better post-mortem position will need to be paid for by the client, not from the declining elder's estate.

CALPERS survivor annuity now available to same-sex-couple retirees

If some of your retiree clients have CALPERS pensions, **retired before 2005**, and are long time unmarried same-sex partners (or opposite-sex partners, where one or both were over age 62 at retirement), ask whether they want to arrange for the survivor to get a retirement CALPERS annuity. Before 2005, CALPERS did not offer same-sex couples or opposite-sex unmarried couples over age 62 the opportunity to choose a survivor annuity. The retirement pension check ended with the retiree.

Because of the California domestic partner law, the retiree (and, if the retiree is deceased, the retiree's surviving partner) can now qualify for the survivor annuity by filing an affidavit of domestic partnership for survivor continuance. The signature of a deceased member is not required. The couple must meet the test for domestic partner registration as of the date of the pre-2005 retirement, must collect proof of co-habitation, etc.

The CALPERS survivor continuance annuity, if awarded to a surviving domestic partner, will entitle the recipient to health and dental coverage, and the long term care insurance (LTCI) group plan. (Rates for CALPERS LTCI will raise an average of one third, effective 7/1/2007—but that is another story.)

The development of domestic partner, civil union, and other legislation that protects same-sex couples will mean enhanced rights of all sorts for these citizens. Comparing how Washington, California, and Oregon domestic partner protections are similar—and different—is a passion of mine. Close attention to the potential created by the new laws produced an immediate practical benefit for one client: the 82-year-old retiree now can afford to stay in her home. I convened a same-sex couple planning group in Portland last fall to begin a local discussion of this emerging body of law to protect same-sex couples. ■

Practice tip:

Frame pleadings and all arguments in a protective proceeding to cover issues relevant to the protected person's welfare.

Report on the Elder Law Section unCLE Program

By Mark M. Williams, unCLE Program Chair

The Elder Law Section once again sponsored its unique program that gives practitioners the opportunity to get together for a day of brainstorming, networking, and the exchange of ideas and forms. Registration met its 75-participant limit nearly two weeks ahead of the event, which was held on Friday, May 4, 2007, at the Valley River Inn in Eugene, Oregon.

The sessions covered a variety of topics, including post-DRA planning techniques, trust funding problems, guardianship and conservatorship administration and contests, office management, long term care, elder abuse litigation, and ethical issues.

Every single person who filled out an evaluation form indicated that he or she would come to another unCLE program and would recommend it to other elder law practitioners—although some expressed concern that recommending it to others might limit one's own opportunity to attend again.

The only criticism of the event was the impossibility of attending more than four of the small group sessions. The consensus was that this may be the best educational opportunity available to us.

The next unCLE program has already been scheduled for May 9, 2008, at the Valley River Inn in Eugene. Mark your calendars and look for registration information early in 2008. ■

Steve Owen moderated the session on Investigating Elder Financial Abuse, one of the 15 topics on which section members shared information about strategies and resources.

Long breaks between sessions allowed unCLE participants time to network with colleagues from around the state.

The day ended with a reception that featured good food and drink, opportunities to connect with friends, and entertaining stories.

Important elder law numbers

as of July 1, 2007

Supplemental Security Income (SSI) Benefit Standards	Eligible individual........$623/month Eligible couple........$934/month
Medicaid (Oregon)	Long term care income cap........$1,869/month Community spouse minimum resource standard........$20,328 Community spouse maximum resource standard........$101,640 Community spouse minimum and maximum monthly allowance standards........$1,712/month; $2,541/month Excess shelter allowance........Amount above $514/month Food stamp utility allowance used to figure excess shelter allowance........$303/month Personal needs allowance in nursing home........$30/month Personal needs allowance in community-based care........$141/month Room & board rate for community-based care facilities........$483.70/month OSIP maintenance standard for person receiving in-home services........$624.70 Average private pay rate for calculating ineligibility for applications made on or after October 1, 2006........$5,360/month
Medicare	Part B premium........$93.50/month* Part B deductible........$131/year Part A hospital deductible per spell of illness........$992 Part D premium: Varies according to plan chosen........average is $27.35/month Skilled nursing facility co-insurance for days 21-100........$124/day * A person whose income is more than $80,000/year will pay a higher

Newsletter Board

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Save the date!

Friday, October 5, 2007
OSB Elder Law Section fall CLE program

Friday, November 2, 2007
Oregon Women Lawyers fall CLE program

November 1–4, 2007
NAELA Advanced Elder Law Institute

January 25–27, 2008
NAELA unProgram

May 9, 2008
OSB Elder Law Section unCLE program