

Deducting expenses for your special need person

(This information is not intended to replace the assistance of a tax professional)

If you have a child with a severe learning disability (LD), you may qualify for valuable tax benefits. If your child has AD/HD, or other physical, mental, or emotional impairment, you may also qualify for tax benefits. Because tax laws are complex, and many tax preparers often do not have occasion to use these unique tax benefits, families are at risk of losing refunds worth many thousands of dollars. It's likely that 15-30 percent of families with a disabled child have one or more unclaimed tax benefits.

This guide provides a brief summary of the most significant federal income tax benefits and should not be considered legal advice. Tax decisions should not be made simply on the basis of the information provided here. You are advised to print out this guide and give a copy to your tax advisor. You should also explore potential state income tax benefits, which are too numerous for review in this guide.

Internal Revenue Service (IRS) "Publications" represent the most accessible form of guidance to the tax rules for the general public, and relevant IRS publications are cited for each of the tax benefits listed below. The IRS also issues interpretations of the code and regulations called "Revenue Rulings." These interpretations are formal, binding policy statements. Tax professionals rely on revenue rulings in advising clients about tax liabilities and tax benefits. For example, Revenue Ruling 78-340, discussed later, authorizes a medical expense deduction for tuition or tutoring fees paid for a child with a severe LD who is attending a special school at the recommendation of the child's doctor.

Tax Benefits: Deductions vs. Credits

It's important to distinguish between two different categories of tax benefits. One category is a "deduction from taxable income" or simply "a deduction." The value of a deduction is based on the marginal tax rate of the taxpayer. If a person has a tax deduction "worth \$1,000," the actual value of the deduction will be determined by the taxpayer's tax rate. So a taxpayer in the lowest tax rate bracket, 10 percent, will have taxable income reduced by \$1,000, and save \$100 (10 percent of \$1,000). However, a taxpayer in a higher bracket, for example, 28 percent, will have taxable income reduced by \$1,000, and save \$280 (28 percent of 1,000).

The second tax benefit is a tax credit, which is a dollar-for-dollar reduction in tax liability. An individual with a tax credit worth \$1,000 will have his tax bill reduced by \$1,000. This means that the actual amount of taxes is reduced by the amount of the tax credit. However, because tax laws and procedures are very complicated, other factors can influence the ultimate value to the taxpayer.

The following summarizes the principal tax benefits that may be available to families caring for children with severe learning disabilities.

Retroactive Claims for Refunds

The IRS allows taxpayers to file amended returns, and collect refunds for unclaimed tax benefits, retroactively up to three years. This means a taxpayer can file an amended return for the 2002 tax year (and also for the 2003 and 2004 tax years) and claim a refund if the return is filed not later than April 15, 2006. (See IRS Publication 17, Your Federal Income Tax, 2005, at pp. 18-19.)

Medical Expense Deductions

The IRS has ruled that tuition costs for a special school that has a program designed to educate children with learning disabilities and amounts paid for a child's tutoring by a teacher specially trained and qualified to deal with severe learning disabilities may also be deducted. (Revenue Ruling 78-340, 1978-2 C.B. 124.) Special instruction or training or therapy, such as sign language instruction, speech therapy, and remedial reading instruction also would be deductible. Related books and materials can qualify for the medical expense deduction.

Generally, to qualify for the deduction, the child's doctor must recommend the special school, therapy, or tutoring, and there must be a medical diagnosis of a neurological disorder, such as severe LD, made by a medical professional. Transportation expenses to the special school or to the tutor also qualify for a medical expense deduction. If transportation is by car, the allowable expense in 2008 is twenty three cents per mile plus parking and tolls, or the actual cost of operating the vehicle.

Diagnostic evaluations also qualify for a medical expense deduction. This can include testing by a speech-language pathologist, psychologist, neurologist, or other person with professional qualifications.

Note: Expenses claimed as a medical expense deduction and later reimbursed by a school district or insurance company must be reported as taxable income for the year in which the reimbursements are received.

Not everyone who has medical expenses can use them on their tax return. Medical expenses must be claimed on Schedule A, Itemized Deductions, and are subject to certain limitations. First, the family must have itemized deductions that exceed their standard deduction in order to use Schedule A (about 65 percent of taxpayers do not itemize for this reason). Second, medical expenses are allowed as a deduction only to the extent that they exceed 7.5 percent of adjusted gross income, a significant threshold for many families. (See IRS Publication 502, Medical and Dental Expenses.)

Health Saving Accounts & Flexible Savings Arrangements

Alternative approaches to obtaining tax benefits in connection with medical expenses may involve use of a Health Saving Account (HSA) or a Flexible Savings Arrangement (FSA). An HSA allows a worker to use up to \$5,250 in pretax income for medical expenses. An HSA may only be opened where the employee has a “high deductible” health insurance plan. Amounts placed in an HSA may be carried over to following years if not used.

A Flexible Savings Arrangement (FSA) can be part of a “cafeteria plan” of alternative fringe benefits offered by an employer. An employee can allocate pre-tax income to the account, and then withdraw it during the year to pay for medical expenses. Employers may also make contributions to the FSA, and the maximum amount is set by the terms of the employer plan. Two important conditions are that the amount to be placed in the account must be determined by the employee at the beginning of the year, and funds not used by the end of the year are lost. The employer’s human resource office can provide more information. Also, see IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Deduction for Disability Related Conferences

In May 2000 the IRS issued Revenue Ruling 2000-24, which offers guidance — and good news — for parents of children with disabilities. Parents who attend conferences to obtain medical information concerning treatment for and care of their child may deduct some of the costs of attending a medical conference relating to a dependent’s chronic health condition. The important points to remember are:

- Medical expenses are deductible only to the extent that they exceed 7.5 percent of an individual’s adjusted gross income, and that limitation applies to this deduction as well;
- Costs for admission and transportation to a medical conference relating to your dependent’s chronic health condition are now deductible, if the costs are primarily for and essential to the care of the dependent.
- Costs of meals and lodging related to a conference, however, are **not** deductible. (Note, however, lodging, up to \$50 per night, is deductible if you must travel and stay at a hotel while your dependent is receiving medical treatment from a licensed physician in a hospital or a related or equivalent setting.)
- Costs are “primarily for and essential to the care of the dependent” (and therefore deductible) if:
 - The parent attends the conference upon the recommendation of a medical provider treating the child;

- The conference disseminates medical information concerning the child's condition that may be useful in making decisions about the treatment of or caring for the child;
- The primary purpose of the visit is to attend the conference. While at the conference, the parent's social and recreational activities in the city he or she is visiting are secondary to attendance at the conference;
- The conference deals with specific issues related to a medical condition and does not just relate to general health and well-being.

Child and Dependent Care Credit

The Child and Dependent Care Credit is allowed for work-related expenses incurred for dependents of the taxpayer. Generally the dependent must be under the age of 13. However, if the child has a disability and requires supervision, the age limit is waived. For example, a 16-year-old with severe AD/HD and a behavior disorder who cannot be left without adult supervision would be a qualifying child for this credit.

Expenses up to \$3,000 per year for one qualifying dependent and up to \$6,000 for two or more qualifying dependents are allowed. Expenses for regular childcare services, after-school programs, and summer camp qualify although overnight summer camp expenses do not. Payments to a relative to care for a child also qualify, as long as the relative is not a dependent of the taxpayer. The credit is calculated at 20-35 percent of allowable expenses, based on the family's adjusted gross income. The average credit is about \$600 but can be as high as \$2,100. (See IRS Publication 503, *Child and Dependent Care Expenses*.)

Exemption for Dependents

A taxpayer is entitled to claim an exemption for each qualified dependent. This may appear relatively straightforward, but caretakers, such as grandparents, aunts, or even foster parents, may overlook exemptions. Also, in some cases following a divorce, a non-custodial parent who provides the majority of support for a child with a severe LD, and also pays for medical/educational expenses related to the child's LD, may likewise qualify for both the exemption and medical expense deductions. A new definition of "qualifying child" took effect in the 2005 tax year; the most significant change is that the taxpayer need not show support for a "qualifying child" but the child must have lived with the taxpayer for more than six months during the tax year. For each dependent, there is an exemption from taxable income, worth \$3,200 for the 2005 tax year. For a taxpayer with a marginal tax rate of 25 percent, each exemption will reduce the tax liability by \$800. Equally important, the dependency status is required for some tax benefits such as the child and dependent care credit listed above. Also dependents under age 17 qualify for the Child Tax Credit, worth up to \$1,000 per child. (See IRS Publication 501, *Exemptions, Standard Deduction and Filing Information, and Instructions to Form 1040*.)

Earned Income Tax Credit

Families filing a married joint return with adjusted gross income under \$37,263 (\$1,000 less for taxpayers filing as single or head of household) may qualify for the Earned Income Tax Credit (EITC) based on the presence of one or two “qualifying children” in the taxpayer’s home. For EITC purposes, a “qualifying child” is 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. A “qualifying child” is also a child age 19-23 who is a full-time student for at least one semester. Finally, a severely disabled child is a “qualifying child” without regard to age, even into adulthood, as long as the child continues to live with his parent(s). Note that a “qualifying child” for EITC does not have to meet the requirements for a dependency exemption. EITC benefits are as high as \$4,400 for families with two or more qualifying children, although the average EITC nationally is about \$1,800. (See IRS Publication 596 for more information.)

Where to Get More Information

The IRS provides free booklets that cover each of the topics listed above. The titles listed below may be ordered by calling the IRS toll-free number: (800) 829-3676. Generally, taxpayers may order up to three copies of any publication or form. The following booklets may be helpful:

- IRS Publication 17: “Your Federal Income Tax” (a comprehensive 300+ page guide)
- IRS Publication 502: Medical and Dental Expenses
- IRS Publication 503: Child and Dependent Care Expenses
- IRS Publication 501: Exemptions, Standard Deduction and Filing Information
- IRS Publication 596: Earned Income Tax Credit
- IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans

Extensive information can also be obtained from the IRS. The American Bar Association Section on Taxation contains links to scores of tax related sites.

Tax Counseling and Tax Preparation Assistance

Certified Public Accountants (CPAs) represent one source of tax advisors, although not all CPAs have expertise in this area. Enrolled Agents are individuals licensed by the IRS to represent taxpayers, and this group generally has a high degree of expertise.

Typically, charges for a tax return with multiple deductions and credits will cost \$150-300. Several national companies provide tax preparation and tax counseling services. Many operate only during the tax filing season but a small number in larger urban areas are open year round. Fees charged by these companies are slightly lower than the fees typically charged by CPAs and Enrolled Agents.

Some parents may not be able to afford fees charged by professional tax preparers, who generally seek payment in advance. An option for lower income clients is the Volunteer Income Tax Assistance (VITA) program. However, because of broad range in skills and expertise of volunteers, caution is recommended. Some large cities have one or more VITA programs that offer professional level services. A university accounting department or the local legal services program may be able to help you identify a high quality VITA program.

Disputes with the IRS

Disputes with the IRS are relatively rare; less than 1.5 percent of all individual income tax returns are subject to an IRS audit. However, if the IRS questions your return, and you feel an IRS agent is not responding properly, contact the Taxpayer Advocate for assistance -- toll-free: (877) 777-4778. Low Income Taxpayer Clinics are another source of help. The IRS funds more than 100 clinics to represent lower income taxpayers in disputes with the IRS or state revenue departments. Clinics assist taxpayers with income under 250 percent of the poverty level -- about \$49,000 for a family of four. Some clinics, especially those attached to law schools, will represent higher income families. Information on the nearest clinic can be obtained from the general IRS toll-free inquiry number: (800) 829-1040. Families above this income level should call their county or state bar association.

Final Thoughts

This guide offers a brief summary of some, but not all, of the potential tax benefits that may be available to you. You should obtain copies of the IRS publications cited above and discuss with your tax advisor whether these benefits apply to you. **Again, you should not rely on this guide alone to determine whether you should claim any of the tax benefits reviewed here.**

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