The American population, like many in the world, is aging. With medical advances, new technologies, better understanding of health issues, and changing life habits, people are living longer. Citizens older than 62 make up 14.6% of the U.S. population. The Internal Revenue Code has provisions that apply to taxpayers in general, as well as special provisions that apply to senior citizens. This chapter discusses planning and other issues regarding tax management for taxpayers in their later years.

I. TAX ISSUES IMPACTING SENIOR CITIZENS

CAPITAL GAINS
Taxpayers fund retirement in a variety of ways. One way is collecting. Collecting stamps, coins, dolls, and commemorative plates are examples of how taxpayers derive enjoyment from a hobby interest.
over a lifetime, and have a capital asset comprised of collectibles. Retirement cash needs may be funded by the sale of the collection in whole or in part. Collectible capital gains are taxed at a maximum rate of 28%, not 20%.

**Example 1.** Gold Smith collected coins over his lifetime. Gold is retired and wants to take a trip to Europe, and he decides to pay for this trip by selling part of his coin collection. Gold is in the 31% tax bracket. He sells part of his coin collection for $10,000, and he has determined that his basis for this part of his collection is $2,000. Therefore the gain is $8,000. Gold will pay $2,240 (28% x $8,000) federal income tax on that gain, plus any state tax that may apply.

Capital assets and the gains that may be recognized by a taxpayer upon sale is an issue that senior taxpayers must consider. One way a taxpayer may defer tax is to give assets rather than cash to beneficiaries such as children. However, care and thought should be given as to which asset to give away during lifetime and which asset to pass at death.

**Observation.** Tax practitioners may help clients evaluate sale of other “true” capital assets.

**Example 2.** Snowy White has been successful in building a closely held family business. Fair market value (FMV) of her shares is $650,000. She owns the majority interest in the company. Her three children own the balance. Snowy has company bonds and debentures that are being paid off as they come due, and these cash flows have been providing Snowy with a supplemental retirement income. Snowy wishes to treat each of her children equitably. However, one son, Bob, has remained with the company and helped to build it to what it is today. Snowy is concerned that if she turns over controlling interest of the business to her children, with Bob receiving the new controlling interest, the bonds and debentures may not be paid in a timely fashion following the transfer. She is concerned that she will not receive the cash needed to maintain her current lifestyle.

**Question 2.1.** If Snowy sells her stock to her children, what then?

**Answer 2.1.** If Snowy were to sell her stock to her three children, she would recognize gain on the stock she has held for over one year as long-term capital gains, and the federal tax would be 20%, plus any state tax. Snowy would then have cash to invest and create funds for retirement needs. The control of the company would be in the hands of her children. The issue of paying bonds and debentures in a timely manner needs to be addressed for both the company and Snowy.

**Question 2.2.** If Snowy gives stock to her children, what then?

**Answer 2.2.** If Snowy gives her stock to the children, capital gains are not recognized. Snowy’s carryover basis becomes the children’s basis. However, gifts over the annual gift exclusion ($10,000 for 2001) uses part of the $675,000 (for 2001) applicable exclusion amount. Control is lost similar to a sale, as described in Answer 2.1, with similar questions as to payment of bonds and debentures.

**Question 2.3.** If Snowy leaves stock to be inherited, what then?

**Answer 2.3.** If Snowy elects to hold on to her stock and pass it to her children through inheritance upon her death, the stock would receive a basis adjusted to fair market value on date of death. This option provides for possibly the most favorable tax planning for Snowy and her children. Furthermore, Snowy maintains control of the company by her majority ownership, ensuring that bonds and debentures continue to be paid in a timely fashion to provide for retirement needs.
REVERSE MORTGAGES

Senior taxpayers may have increasing needs for cash to pay for living expenses if they are on fixed retirement incomes. Recently, a financial instrument called a reverse mortgage has brought a new tool to provide increased cash on a regular basis for persons in need of extra cash.

In the past, taxpayers who wanted to access the equity in their homes and turn it into cash had only two options. The first was to sell, but that meant the taxpayer had to move. The second method was to obtain a home equity loan, but that meant making periodic payments in an already tight cash flow. The reverse mortgage is a new tool that allows taxpayers with equity in their homes to realize cash without having to move or make payments.

A reverse mortgage is a loan against the equity in the taxpayer’s home that the taxpayer does not have to pay back as long as the taxpayer lives in the home. The proceeds of the loan may be paid in a lump sum, or by a regular monthly advance, or at times, at an amount that the taxpayer requests. The loan is repaid plus interest when the taxpayer dies, sells the home, or permanently moves from the home.

Who Is Eligible

To be eligible for a reverse mortgage, taxpayers must be at least 62 years of age. Taxpayers must own and occupy the home as their principal residence. Single-family one-unit structures are eligible property for reverse mortgages. Similarly, some programs that offer reverse mortgages will accept up to a four-unit structure if the owner lives in one unit. Likewise condominiums, planned unit developments (PUDs), and manufactured homes are eligible for a reverse mortgage. Generally, cooperatives and mobile homes will not meet the requirements of a reverse mortgage.

How a Reverse Mortgage Works

In general, reverse mortgages do not require repayment of the loan as long as the taxpayer and spouse reside in their principal residence. Reverse mortgages are paid in full, including all charges and accrued interest, when the last surviving borrower dies, sells the principal residence, or moves to another principal residence (typically a long-term care arrangement).

Since the taxpayer does not make payments each month, the amount owed to the lending institution grows larger over the life of the loan. Therefore, as the debt increases, the amount of equity that would be realized upon sale of the principal residence decreases. Taxpayers can never owe more than the value of the principal residence under loan at the time the debt is repaid. This is a safety measure built into the reverse mortgage.

Since the taxpayer still owns the home in which he or she lives, obligations of ownership still exist. Taxpayers must maintain the home in good repair, and pay insurance and property taxes in a timely manner. Should the taxpayer fail to do so, the loan could be called and become payable to the creditor in full.

How Reverse Mortgages Provide Cash Flow

Since taxpayers will never owe to the creditor an amount greater than the value of the home for the total debt, charges, and accrued interest, the amount that can be borrowed is limited by the life expectancy of the borrower(s). Generally, 35 to 55% of the fair market value of equity in the home is available to be used for a reverse mortgage. The older the taxpayer, the greater the amount of equity available to be loaned. The amount that can be borrowed also depends on the type of reverse mortgage a taxpayer
chooses. Reverse mortgages are available from both public and private sources. Generally, public sources require specific use of the funds, for example, to make home repairs or pay property taxes. Private sources do not have limitations on the use of loan proceeds.

Reverse mortgages can be paid in lump-sum payment to the taxpayer once the loan is closed. Or, to assist with monthly cash flow for senior citizens, the reverse mortgage can be designed to provide a monthly loan advance. The third option is to have the reverse mortgage arranged as if it were a “credit line,” where the taxpayer can choose the loan amount and when it will be advanced. Depending on the product, a combination of the three methods may be employed.

**What the Taxpayer Pays for a Reverse Mortgage**

As in the case of most loans, there are costs associated with reverse mortgages. Generally, reverse mortgages offered by the public sector have lower loan costs. Costs common to reverse mortgages are application fees that typically cover the appraisal of the property to be mortgaged, and credit report. Other loan costs would include origination fee, insurance, other closing costs, and, if the taxpayer selects a monthly loan advance, possibly a monthly servicing fee applied to the loan.

Taxpayers considering the use of a reverse mortgage to access the equity in their principal residence to provide needed cash flow for retirement funding should evaluate costs of all plans that might be available. Costs associated with reverse mortgages vary greatly across programs.

**Other Important Issues with a Reverse Mortgage**

If the taxpayer receives Medicaid, Supplemental Security Income (SSI), or any other type of assistance of a public nature with rules similar to Medicaid or SSI, the taxpayer must use the loan advance in the month the loan advance is received. Loan advances from reverse mortgages are treated as “liquid assets.” There are limits under public assistance programs as to how much a taxpayer may have in liquid accounts. If the amount goes over the program limit, the taxpayer may lose the benefits of the public assistance program.

**Income Tax Consequences of a Reverse Mortgage**

Funds received by a taxpayer from a reverse mortgage on the taxpayer’s principal residence are not taxable to the taxpayer. Loan proceeds are not taxable income by IRS definition.

**Example 3.** Merle (69) and Linda (65) Jones are retired. They own the home they have lived in for the past 15 years. No debt is against the home; the home’s current FMV is $200,000. Recently, the Joneses have developed a need for increased monthly cash flow beyond what their fixed retirement funds are providing. They investigate the reverse mortgage as a tool to help increase monthly cash flow. The Joneses are eligible to use up to 37.2% ($74,410) of their equity as a lump-sum payment. Merle and Linda may also take monthly loan advances against the equity in their home for a term of 21 years. This option will allow for a monthly amount of $565 to be advanced to them ($142,380 over 21 years).

Neither the $74,410 lump sum payment nor the $565 per month is taxable to the Joneses, since they are loan advances under the reverse mortgage program. If Merle and Linda pay out-of-pocket the closing costs at closing, points paid, if any, may be an itemized deduction in the year paid [Treas. Reg. §1.163-10T(j)(2)(I)].
Example 4. From Example 3, Merle and Linda choose to have the monthly loan advance of $565. They continue to reside in the home as their principal residence. Merle passes away three years into the reverse mortgage agreement. Linda continues to live in the home and receive the loan advance payments of $565. Linda dies at the end of the fifth year. The total loan proceeds to Merle and Linda over the five years are $33,900. Interest has accrued at a rate of 7% on the advanced payments. Linda’s estate, since she is the last borrower to die, must pay the loan back and any accrued interest. The total that is owed the creditor is $40,444.02, of which $6,544.02 is interest.

Since all the payments to the date of Linda’s death were loan advances, there is no taxable income. However, now the loan must be paid back with the accrued interest. The estate may be entitled to the interest deduction of $6,544.02 (assuming that the loan is paid on the date of death).

A second option that might be available is that the interest of $6,544.02 might be deducted as an itemized deduction on Linda’s final income tax return as qualified residence interest [I.R.C. §163(h)(3)(A)].
Example 5. Using the same information as in Example 3, after five years, Merle and Linda sell their home and move to a retirement community. Since sale of the principal residence is a condition under which a reverse mortgage is to be repaid, the sale results in the following tax implications. Assuming the house has gained an additional 10% appreciation, the FMV is now $220,000. Merle and Linda net, after sales expenses, $202,400. Basis in the home is $100,000.

The gain of $102,400 is not taxable, as it is excluded up to a maximum value of $500,000 for married taxpayers filing joint returns, or $250,000 for single filers (I.R.C. § 121).

The reverse mortgage is paid in full: $33,900 is principal repayment and not deductible, $6,544.02 is accrued interest that is paid at the termination of the mortgage. Merle and Linda may deduct this interest as an itemized item on Schedule A, since they are cash basis taxpayers, and they pay interest at this time on their home equity reverse mortgage loan [I.R.C. § 163(h)(3)(A)].

### Schedule A—Itemized Deductions

#### Merle & Linda Jones

<table>
<thead>
<tr>
<th>Medical and Dental Expenses</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Multiply line 2 above by 7.5% (.075)</td>
</tr>
<tr>
<td>2.</td>
<td>Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Taxes You Paid</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>5.</td>
<td>State and local income taxes</td>
</tr>
<tr>
<td>6.</td>
<td>Real estate taxes (see page A-2)</td>
</tr>
<tr>
<td>7.</td>
<td>Personal property taxes</td>
</tr>
<tr>
<td>8.</td>
<td>Other taxes. List type and amount</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Interest You Paid</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10.</td>
<td>Home mortgage interest and points reported to you on Form 1098</td>
</tr>
<tr>
<td>11.</td>
<td>Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person’s name, identifying no., and address</td>
</tr>
</tbody>
</table>

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RETIREMENT ACCOUNT CASH DISTRIBUTIONS

Taxpayers who are receiving payments from retirement accounts, deductible IRAs, SEP IRAs, 401(k)s, pension funds, and so on, receive these cash distributions subject to ordinary tax rates. Two of the major benefits of investing in these type of accounts are the tax deferral of the contribution in the year made, and the tax-deferred growth of the retirement asset account.

Frequently, taxpayers wonder why they may not benefit from preferential capital gains rates of taxation when these retirement account instruments are invested in equities or other capital assets. The answer is simple. The taxpayer has not paid tax on the original contribution, nor has the taxpayer paid tax on the gains that the retirement account has accrued over time. Even though the retirement account has “capital gains” as part of the growth in value, these gains do not retain that character of income to the now retired taxpayer as he or she takes distributions from the accounts. All retirement account distributions are taxed at ordinary income tax rates [I.R.C. §402].

Example 6. Ima Fisching retired from his work at a manufacturing plant at the end of June 2001. Ima begins to withdraw retirement payments from the 401(k) that was part of his benefit package from his former employer. Ima selected that all of his 401(k) funds (both employee and employer contributions) be invested in equities. Over the course of his career, his 401(k) has grown in value above original contributions. His distribution from his 401(k) is expected to be $20,000 annually. All of this income is taxed at ordinary income tax rates.

Practitioner Note. If the pension is fully taxable, do not make an entry in line 16a.

RESTITUTION PAYMENTS

Within the Economic Growth and Tax Relief Reconciliation Act of 2001, §803 (not inserted into I.R.C.) provides that Holocaust victims and their heirs receiving restitution payments may exclude these payments from gross income.

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II. LONG-TERM CARE INSURANCE

A qualified long-term care (LTC) insurance contract provides coverage only for qualified long-term care services. The contract:

1. Must be guaranteed renewable.
2. Must not provide for a cash surrender value or for other money that can be paid, assigned, pledged, or borrowed.
3. Must provide that refunds, other than refunds upon the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract, must be used only to reduce future premiums or increase future benefits.
4. Generally must not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary provider, or where the contract makes per diem or other periodic payments without regard to expenses.

Long-term care insurance premiums are deductible as medical expenses subject to the 7.5% of adjusted gross income floor, but the deductions for 2001 are limited further to the following amounts:

<table>
<thead>
<tr>
<th>Before End of Tax Year</th>
<th>Limit on Deduction for Premium Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>40 or less</td>
<td>$230</td>
</tr>
<tr>
<td>41 to 50</td>
<td>$430</td>
</tr>
<tr>
<td>51 to 60</td>
<td>$860</td>
</tr>
<tr>
<td>61 to 70</td>
<td>$2,290</td>
</tr>
<tr>
<td>71 and above</td>
<td>$2,860</td>
</tr>
</tbody>
</table>

Long-term care insurance that is provided under an employer’s plan is typically treated as an accident and health plan, and the value of coverage is excludable from the employee’s income.

**Per Diem Benefits.** Some long-term care insurance contracts pay a specific amount per day, without regard to the actual cost of the long-term care being provided to the patient. This type of benefit can generally be excluded from gross income up to a limit of $200 per day ($73,000 per year) for 2001. The $200 is indexed for inflation. (I.R.C. §7702B).

This limit on the exclusion is ignored if one of the following is true:

1. The actual cost of the long-term care is equal to or more than the per diem payment, even if the per diem exceeds the cap.
2. The taxpayer is terminally ill and has been certified by a physician as having a physical condition that reasonably can be expected to result in death within 24 months of the certification date.

**Lifetime Care: Advance Payments.** Some retirement homes offer a program whereby an individual pays a lifetime care fee or “founder’s fee.” The fee is paid either periodically (quarterly, for example), or as a one time payment under an agreement with the retirement home. The part of the payment that is properly allocable to medical care may be claimed as a medical deduction. The agreement must require a specific fee as a condition for the retirement home’s promise to provide lifetime care that includes medical care.

**Practitioner Note.** Generally, medical expenses do not include current payments for medical care to be provided substantially beyond the end of the year. This does not apply, however, in situations where future care is purchased in connection with obtaining lifetime care as described above.
Example 7. Jake Marley purchased a long-term care insurance contract from Wecoveryou Insurance Company early in 1997. Under the terms of the policy, $110 per day was to be paid for any day that he was a nursing home resident. This is a per diem type policy, and the $110 per day benefit is to be paid without regard to the actual nursing home expenses incurred.

Jake became ill in 2001 and was certified by his physician in August of 2001 as chronically ill due to a disease (Alzheimer’s) that resulted in severe cognitive impairment. He entered Stayewithus Nursing Home on September 26, 2001, and remained there through December 31, 2001. In January 2002 he received a Form 2001 1099-LTC from the Wecoveryou Insurance Company, showing a total paid amount of $7,260 in long-term care benefits.

The insurer paid benefits for the 97 days Jake was in the nursing home in 2001 as follows:

<table>
<thead>
<tr>
<th>Benefit Month</th>
<th>Days</th>
<th>Rate</th>
<th>Paid</th>
<th>Benefits Check Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>5</td>
<td>$110</td>
<td>$550</td>
<td>November 5, 2001</td>
</tr>
<tr>
<td>October</td>
<td>31</td>
<td>$110</td>
<td>$3,410</td>
<td>November 22, 2001</td>
</tr>
<tr>
<td>November</td>
<td>30</td>
<td>$110</td>
<td>$3,300</td>
<td>December 22, 2001</td>
</tr>
<tr>
<td>Box 1 on 2001 1099-LTC</td>
<td></td>
<td></td>
<td>$7,260</td>
<td></td>
</tr>
<tr>
<td>December</td>
<td>31</td>
<td>$110</td>
<td>$3,410</td>
<td>January 22, 2002</td>
</tr>
</tbody>
</table>

Jake paid the nursing home a regular rate of $125 per day as follows:

<table>
<thead>
<tr>
<th>Month</th>
<th>Days</th>
<th>Rate</th>
<th>Paid</th>
<th>Date Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>5</td>
<td>$125</td>
<td>$625</td>
<td>September 30, 2001</td>
</tr>
<tr>
<td>October</td>
<td>31</td>
<td>$125</td>
<td>$3,875</td>
<td>October 15, 2001</td>
</tr>
<tr>
<td>November</td>
<td>30</td>
<td>$125</td>
<td>$3,750</td>
<td>November 15, 2001</td>
</tr>
<tr>
<td>December</td>
<td>31</td>
<td>$125</td>
<td>$3,875</td>
<td>December 15, 2001</td>
</tr>
<tr>
<td>Total 2000 payments</td>
<td></td>
<td></td>
<td>$12,125</td>
<td></td>
</tr>
</tbody>
</table>

Jake is 58 years old as of December 31, 2001. He paid premiums of $2,500 to Wecoveryou Insurance Company during 2001. Refer to the completed 2001 Form 8853 (Section C only).
### Section C. Long-Term Care (LTC) Insurance Contracts

#### See Filing Requirements for Section C on page 7 of the instructions before completing this section.

<table>
<thead>
<tr>
<th>16a Name of insured</th>
<th>Jake Marley</th>
</tr>
</thead>
<tbody>
<tr>
<td>b Social security number of insured</td>
<td>333:44 5678</td>
</tr>
</tbody>
</table>

17. In 2001, did anyone other than you receive payments on a per diem or other periodic basis under a qualified LTC insurance contract covering the insured or receive accelerated death benefits under a life insurance policy covering the insured? □ Yes □ No

18. Was the insured a terminally ill individual? □ Yes □ No

**Note:** If “Yes” and the only payments you received in 2001 were accelerated death benefits that were paid to you because the insured was terminally ill, skip lines 19 through 27 and enter -0- on line 28.

19. Gross LTC payments received on a per diem or other periodic basis. Enter the total of the amounts from box 1 of all Forms 1099-LTC you received with respect to the insured on which the “Per diem” box in box 3 is checked.

| 19 | 7,260 |

**Caution:** Do not use lines 20 through 28 to figure the taxable amount of benefits paid under an LTC insurance contract that is not a qualified LTC insurance contract. Instead, if the benefits are not excludable from your income (for example, if the benefits are not paid for personal injuries or sickness through accident or health insurance), report the amount not excludable as income on Form 1040, line 21.

20. Enter the part of the amount on line 19 that is from qualified LTC insurance contracts.

| 20 | 7,260 |

21. Accelerated death benefits received on a per diem or other periodic basis. Do not include any amounts you received because the insured was terminally ill. See page 6 of the instructions.

| 21 |  |

22. Add lines 20 and 21.

| 22 | 7,260 |

**Note:** If you checked “Yes” on line 17 above, see the instructions for line 17 on page 6 before completing lines 23 through 27.

23. Multiply $200 by the number of days in the LTC period.

| 23 | 13,200 |

24. Enter the costs incurred for qualified LTC services provided for the insured during the LTC period (see page 6 of the instructions).

| 24 | 8,250 |

25. Enter the larger of line 23 or line 24.

| 25 | 13,200 |

**Caution:** If you received any reimbursements from LTC contracts issued before August 1, 1996, see page 7 of the instructions.

26. Enter the total reimbursements received for qualified LTC services provided for the insured during the LTC period.

| 26 |  |

27. Per diem limitation. Subtract line 26 from line 25.

| 27 | 13,200 |

28. **Taxable payments.** Subtract line 27 from line 22. If zero or less, enter -0-. Also include this amount in the total on Form 1040, line 21. On the dotted line next to line 21, enter “LTC” and the amount.

| 28 | |

### Calculation of Line 23, Form 8853.

The contract period method was used to compute the figure entered on line 23 of the Form 8853 above—the number of days in the LTC multiplied by the allowable amount.
Under this method, the LTC period is the same period the insurance company used under the contract to compute the benefits paid to the insured. Jake’s contract computed benefits on a daily basis ($110 for every day he was in the nursing home). Thus, the LTC period for line 23 is the number of days for which the insurer paid during 2001, not necessarily the number of days Jake was in the nursing home.

Box 1 of the 2001 Form 1099-LTC shows that Jake was paid $7,260, or $110 per day, for 66 days in 2001. Therefore, the LTC period (line 23, Form 8853) is 66 days. The entry for line 23 of Form 8853 is calculated as follows:

$$2001 \text{ daily limitation} \quad $ \quad 200$$
$$\text{Days in the LTC period} \quad 66$$
$$\text{Line 23 amount} \quad $13,200$$

**Calculation of Line 24, Form 8853.** Line 24 is the cost of qualified long-term care services during the LTC period of 66 days.

Because the payment from the insurer for December 2001 (received in January 2002) was not counted, the amount Jake paid the nursing home for December is also not counted.

Jake paid the regular nursing home rate of $125 per day as follows:

<table>
<thead>
<tr>
<th>Month</th>
<th>Days</th>
<th>Rate</th>
<th>Paid</th>
<th>Date Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>September</td>
<td>5</td>
<td>$125</td>
<td>$625</td>
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<tr>
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<td>31</td>
<td>$125</td>
<td>$3,875</td>
<td>October 5, 2001</td>
</tr>
<tr>
<td>November</td>
<td>30</td>
<td>$125</td>
<td>$3,750</td>
<td>November 15, 2001</td>
</tr>
<tr>
<td>December</td>
<td>31</td>
<td>$125</td>
<td>$3,875</td>
<td>December 15, 2001</td>
</tr>
</tbody>
</table>

**Total paid for 2000:** $12,125
**Less December payment:** ($3,875)

**Amount for line 24:** $8,250

**Question 7.1.** How much of the 2001 long-term care benefits is taxable on the joint 2001 tax return of Jake and his wife, Judith?

**Answer 7.1.** None, as shown on line 28 of Form 8853.

**Question 7.2.** Can Jake and Judith deduct any nursing home related medical expenses on Schedule A of their 2001 joint return?

**Answer 7.2.** Yes, as shown below, subject to the 7.5% of adjusted gross income floor.

- **Qualified long-term care premiums—Jake (age 58—see limitations on page 74):** $860
- **Nonreimbursed nursing home expense (see chart below):** + $1,455

**Amount to be included on line 1 of Schedule A:** $2,315

The nonreimbursed nursing home expense is calculated as follows:

- **Line 24, Form 8853:** $8,250
- **Less line 19, Form 8853:** (7,260)
- **Plus Jake’s December nursing home expense paid in December:** 3,875
- **Less expected insurance reimbursement for December:** (3,410)
- **Total to Schedule A as nonreimbursed nursing home expense:** $1,455

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Self-Employed Deduction of Long-Term Care Insurance. Senior citizens who continue to work in a self-employed business such as farming may be able to deduct not only medical and health insurance but also long-term care insurance as an adjustment to income on the front of Form 1040. This adjustment is barred if the taxpayer or the taxpayer’s spouse is eligible to participate in a subsidized health plan provided as a benefit to employees by the employer. However, the test is applied separately to the medical and health insurance and the long-term care insurance [I.R.C. §162(l)(2)(B)].

Example 8. Frank Furter (66) has retired from his job as a bank executive vice-president. Frank, however, has operated a purebred cattle operation and sells yearling bulls and bred heifers. Frank has developed a good regional reputation and his business is profitable. Franks’ wife, Patty, still works as a local schoolteacher. Frank and Patty purchase their medical and health insurance through the school district where Patty is employed. As part of their long-range financial planning, Frank and Patty have purchased a qualified long-term care insurance policy for which they paid $2,300. An LTC policy is not available through the school district or as a retirement benefit from the bank.

Question 8.1. Can Frank and Patty deduct the insurance cost of the long-term care policy as self-employed individuals?

Answer 8.1. Yes, applying the code section listed above, Frank and Patty can segregate the premiums that are personally paid and can deduct 60% of the premiums as an adjustment to income (60% of $2,300 = $1,380).

Practitioner Note. Self-employed individuals, partners, and greater-than-2% shareholders of S corporations may deduct 60% of health insurance in 2001, 70% in 2002, and 100% in 2003.
Who Should Have Long-term Care Insurance? Frequently, income tax practitioners are asked to give planning advice to their clients. During these opportunities, the practitioner may play the role of a “sounding board” and offer suggestions as the client “thinks out loud.” The issue of who should have long-term care insurance, and the corresponding financial ramifications to the client, may fall outside of the professional “comfort zone” of the practitioner.

Long-term care insurance is available in many forms, with many options, at various price levels. The financial decision that must be made by the taxpayer is how much risk the taxpayer is willing to accept, and what coverage, if any, can the taxpayer afford. The tax practitioner can explain the tax benefits of long-term care insurance.

Example 9. Granny Brown is a widow who has three children. Lucy the eldest has recently separated from her husband, has gone back to work, and lives in a four-bedroom home with her two children (ages 12 and 14). Jim lives several states away. Nellie, the youngest, is happily married and lives with her three young children in a small but comfortable three-bedroom home. Granny has fallen and broken her hip due to osteoporosis and requires a long recuperation with medical care. Granny has nearly $80,000 in savings and a comfortable retirement income, thanks to her late husband’s life insurance and pension.

The family does not want to put Granny into a nursing home. However, in-home nursing care will seriously deplete Granny’s savings during the recovery period. Furthermore, Medicare will not cover many of the medical expenses in full.

One solution is to have Granny move into Lucy’s house and hire a private medical aide for the daytime hours. This is not a feasible solution because Lucy is struggling with the changes in her personal life, and the responsibility of an injured parent is more than she is willing to take on.

Jim lives too far away to be of any assistance in the physical care of his mother; he can only offer “moral support” to his sisters.

Nellie, likewise, is unable to accommodate her mother at her home since there is not room for her. The children are greatly distressed at the remaining prospect. Placing Granny in a long-term care facility goes against family values and promises made long ago to Dad.

A long-term care facility is seemingly the only solution that will provide for proper recovery of Granny’s injury. However, it comes at a financial burden that has the potential to consume many of the assets and savings that Granny and her late husband have accumulated.

This scenario is not uncommon and illustrates some of the conflicts and issues that families face today regarding long-term care. The authors of this text include this example only for illustrative purposes in conjunction with the discussion of tax issues regarding long-term care insurance. The family must come to some conclusion as to how long-term care insurance fits into the family’s financial plans before and after tax considerations.

**TRANSFERRING ASSETS AND LONG-TERM CARE ASSISTANCE**

Clients often ask their tax preparers about transferring assets in order to qualify for medical assistance. Transfers can be made for this purpose, but the rules that govern such transfers are complex. Both state and federal laws must be studied before a preparer can give good advice on such transfers. That discussion is beyond the scope of these materials.
Rather than moving into a long-term care facility that provides both medical and residential services, many senior citizen taxpayers hire private-duty nurses to provide required medical services in their homes. If the services provided are those that a medical nurse performs, the wages, employment taxes, employee benefits, and related expenses qualify as a medical expense that may be deducted on Schedule A (Form 1040). These expenses are deductible even if the person performing the services is not professionally licensed. If the individual hired also performs housekeeping and other personal services, the associated costs must be allocated as to deductible and nondeductible expenses.

Senior taxpayers employing medical aides in the home must file annual returns for the medical aide’s service employment taxes on a calendar-year basis on or before April 15 of the year following the year in which the services were performed (I.R.C. §3510(a)(1 & 2). This may be more familiar to tax practitioners as the “Nanny tax.” The employing senior citizen must report withheld income and employment taxes on Schedule H (Form 1040) and attach it to his or her individual income tax return. Likewise, employing senior citizens must have an employer identification number (EIN), which may be obtained by using Form SS-4.

The dollar amount threshold for payment of FICA and FUTA taxes is $1,300 for 2001. This amount is inflation adjusted annually in increments of $100 [I.R.C. §3121(a)(7)].

Practitioner Note. The dollar amount threshold applies to each medical aide separately. Therefore, if the senior citizen employs three separate individuals as in-house aides and pays each $1,200, no FICA tax is due for any of the three.

Practitioner Note. If medical aide services are performed in the home of a senior citizen by an individual under the age of 18, and the medical service is not the principal occupation of that employee, wages earned are not subject to FICA tax [I.R.C. §3121(b)(21)].

Annual Form 940 (FUTA) is not required to be filed for medical aides employed in the home of the taxpayer. There is no requirement that home-based employers make deposits (monthly or quarterly) of medical aide service employment taxes (I.R.C. §6157).

Medical aides come under the “Domestic service employment” category. Employment taxes for these persons are: (a) any FICA and FUTA taxes owed on the payment for services made by the employer and (b) any income tax on these payments that are withheld under I.R.C. §3402(p), the voluntary withholding agreement rules.

The senior taxpayer who employs a medical aide in his or her home is required to provide a Form W-2 to that employee. The Form W-2 reports wages subject to Social Security (FICA) taxes to the employee and appropriate governmental agencies. Employers must use Form W-3 (transmittal form) to file even one W-2.

Example 10. Jack B. Nymble requires medical assistance during a three-month recovery period from a recent accident. Jack decides against going to live in a long-term care facility during the recovery period. Jack hires a professional medical worker to perform the needed assistance per his doctor’s orders. Jack agrees to hire the services of a medical aide, Yew R. Well. Jack will pay $2,000 per month in wages, plus the employer’s FICA and FUTA taxes.

Question 10.1. Is Jack required to file Schedule H?

Answer 10.1. Yes, Jack has paid Yew R. Well over $1,300 per year, making the wages subject to FICA and FUTA tax, which he agreed to pay.
### Household Employment Taxes

#### Part I  Social Security, Medicare, and Income Taxes

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Line</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Total cash wages subject to social security taxes (see page 3)</td>
<td>1</td>
<td>6,000</td>
</tr>
<tr>
<td>2</td>
<td>Social security taxes. Multiply line 1 by 12.4% (.124).</td>
<td>2</td>
<td>744</td>
</tr>
<tr>
<td>3</td>
<td>Total cash wages subject to Medicare taxes (see page 3)</td>
<td>3</td>
<td>6,000</td>
</tr>
<tr>
<td>4</td>
<td>Medicare taxes. Multiply line 3 by 2.9% (.029).</td>
<td>4</td>
<td>174</td>
</tr>
<tr>
<td>5</td>
<td>Federal income tax withheld, if any</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td><strong>Total social security, Medicare, and income taxes</strong> (add lines 2, 4, and 5)</td>
<td>6</td>
<td>918</td>
</tr>
<tr>
<td>7</td>
<td>Advance earned income credit (EIC) payments, if any</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td><strong>Net taxes</strong> (subtract line 7 from line 6)</td>
<td>8</td>
<td>918</td>
</tr>
</tbody>
</table>

#### Additional Instructions

- **A** Did you pay any one household employee cash wages of $1,200 or more in 2000? (If any household employee was your spouse, your child under age 21, your parent, or anyone under age 18, see the line A instructions on page 3 before you answer this question.)
  - **X** Yes. Skip lines B and C and go to line 1.
  - **No.** Go to line B.

- **B** Did you withhold Federal income tax during 2000 for any household employee?
  - **Yes.** Skip line C and go to line 5.
  - **No.** Go to line C.

- **C** Did you pay total cash wages of $1,000 or more in any calendar quarter of 1999 or 2000 to household employees? (Do not count cash wages paid in 1999 or 2000 to your spouse, your child under age 21, or your parent.)
  - **No.** Stop. Do not file this schedule.
  - **Yes.** Skip lines 1-9 and go to line 10 on the back.

---

**For Paperwork Reduction Act Notice, see Form 1040 instructions.**

**Cat. No. 12187K**

**Schedule H (Form 1040) 2000**

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Copyrighted by the Board of Trustees of the University of Illinois. This information was correct when originally published. It has not been updated for any subsequent law changes.
Question 10.2. Is Jack required to file a Form W-2 for Yew R. Well?

Answer 10.2. Yes, See Form W-2 and W-3 for Yew R. Well and Jack B. Nyable respectively.
<table>
<thead>
<tr>
<th>a</th>
<th>Control number</th>
<th>OMB No. 1545-0008</th>
</tr>
</thead>
<tbody>
<tr>
<td>b</td>
<td>Employer identification number</td>
<td>41-0234567</td>
</tr>
</tbody>
</table>
| c | Employer’s name, address, and ZIP code | Jack B. Nymble  
100 Happy Lane  
Wonder, NC |
| d | Employer’s social security number | 888-77-6543 |
| e | Employee’s first name and initial | Yew R. Well |
| f | Employee’s name and ZIP code | 6,000 |

**Form W-2 Wage and Tax Statement 2001**

DO NOT Staple OR FOLD

<table>
<thead>
<tr>
<th>a</th>
<th>Control number</th>
<th>OMB No. 1545-0008</th>
</tr>
</thead>
</table>
| b | Kind of Payer | Military  
Social security  
Medicare  
Third-party sick pay |
| c | Total number of Forms W-2 | 943 |
| d | Establishment number | 1 |
| e | Employer identification number | 41-0234567 |
| f | Employer’s name | Jack B. Nymble |
| g | Employer’s address and ZIP code | 100 Happy Lane  
Wonder, NC |
| h | Other EIN used this year | |

<table>
<thead>
<tr>
<th>i</th>
<th>State</th>
<th>Employer’s state ID number</th>
</tr>
</thead>
</table>
| j | 16 | State wages, tips, etc.  
6,000 |
| k | 17 | State income tax  
$ |

**Form W-3 Transmittal of Wage and Tax Statements 2001**

Send this entire page with the entire Copy A page of Form(s) W-2 to the Social Security Administration. Photocopies are not acceptable.
Practitioner Note. This discussion addresses monthly survivor and disability benefits and the equivalent railroad retirement benefits. Supplemental security income payments (SSI) are not taxable and are not considered part of the formula when determining the taxable portion of social security benefits. See the Retirement chapter for further discussion of social security benefits.

Social security benefits are taxed under a two-tier system that taxes up to 50% of the benefits the taxpayer’s combined income exceeding the first threshold and up to 85% of the benefits of the taxpayer’s combined income exceeding a second, higher threshold.

For purposes of calculating taxes on social security benefits, combined income is the sum of two figures:

1. The taxpayer’s modified adjusted gross income
2. 50% of the taxpayer’s social security benefits

Modified adjusted gross income is the taxpayer’s adjusted gross income with the following modifications:

1. The following exclusions are not allowed:
   a. Income from U.S. savings bonds used to pay higher education tuition and fees (I.R.C. §135)
   b. Employer-paid qualified adoption expenses (I.R.C. §137)
   c. Foreign-earned income (I.R.C. §911)
   d. Income from sources within Guam, American Samoa, the Northern Marianas Islands, and Puerto Rico (I.R.C. §§931 and 933)
2. The deduction for interest paid on qualified student loans is not allowed.
3. Tax-exempt interest is included.

The thresholds for 2001 vary by the taxpayer’s filing status as follows:

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>If Combined Income is:</th>
<th>Then up to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>More than $25,000</td>
<td>50% of benefits are taxable</td>
</tr>
<tr>
<td></td>
<td>More than $34,000</td>
<td>but not more than $34,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>85% of benefits are taxable</td>
</tr>
<tr>
<td>Married filing jointly</td>
<td>More than $32,000</td>
<td>50% of benefits are taxable</td>
</tr>
<tr>
<td></td>
<td>More than $44,000</td>
<td>but not more than $44,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>85% of benefits are taxable</td>
</tr>
<tr>
<td>Head of household</td>
<td>More than $25,000</td>
<td>50% of benefits are taxable</td>
</tr>
<tr>
<td></td>
<td>More than $34,000</td>
<td>but not more than $34,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>35% of benefits are taxable</td>
</tr>
<tr>
<td>Married filing separately*</td>
<td>More than $25,000</td>
<td>50% of benefits are taxable</td>
</tr>
<tr>
<td></td>
<td>More than $34,000</td>
<td>but not more than $34,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>85% of benefits are taxable</td>
</tr>
</tbody>
</table>

*If taxpayers who are married filing separately live together at any time during the year, then the threshold is zero. Consequently, up to 85% of social security benefits are included in taxable income.
If a taxpayer’s combined income exceeds the 50% threshold but not the 85% threshold listed above, then the taxpayer must include in taxable income the lesser of the following:

1. 50% of social security benefits, or
2. 50% of the amount by which combined income exceeds the 50% threshold

If the taxpayer’s combined income exceeds the 85% threshold listed above, then the taxpayer must include in taxable income the lesser of the following:

1. 85% of social security benefits, or
2. The sum of the following:
   a. 50% of the amount by which the 85% threshold exceeds the 50% threshold
   b. 85% of the amount by which combined income exceeds the 85% threshold

**Tiered System Increases Marginal Tax Rate.** Since the taxability of social security benefits is dependent on other income, some taxpayers are surprised to find that a relatively small amount of additional income pushes them over the threshold for taxing social security benefits and increases the incremental rate of tax.

**Example 11.** Anne A. Belle (66) is single and receives $1,000 per month in social security benefits in 2001. She prepared for her retirement by investing in an IRA, from which she draws $1,500 per month. At this income level, her social security will not be taxed since the $18,000 IRA distribution plus 50% of her social security ($6,000) equals $24,000, which is below the threshold for taxing her social security.

Anne’s 2001 federal income tax is $1,421 as shown below.

<table>
<thead>
<tr>
<th>Amount</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>IRA distribution</td>
<td>$18,000</td>
</tr>
<tr>
<td>Savings bond interest</td>
<td>10,000</td>
</tr>
<tr>
<td>50% of social security benefits</td>
<td>6,000</td>
</tr>
<tr>
<td>Combined income</td>
<td>$34,000</td>
</tr>
<tr>
<td>Less: 50% threshold</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Excess over threshold</td>
<td>$ 9,000</td>
</tr>
</tbody>
</table>

**Example 12.** Assume the same facts as in Example 11 except that now Anne also has Series EE savings bonds that matured. She cashes them and receives $10,000 of interest income.

The calculation to determine if any of her social security benefits will be taxed has a different result. **Anne’s combined income is $9,000 over the 50% threshold as shown below.**

<table>
<thead>
<tr>
<th>Amount</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>IRA distribution</td>
<td>$18,000</td>
</tr>
<tr>
<td>Savings bond interest</td>
<td>10,000</td>
</tr>
<tr>
<td>50% of social security benefits</td>
<td>6,000</td>
</tr>
<tr>
<td>Combined income</td>
<td>$34,000</td>
</tr>
<tr>
<td>Less: 50% threshold</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Excess over threshold</td>
<td>$ 9,000</td>
</tr>
</tbody>
</table>

Fifty percent of that excess ($4,500) is added to taxable income. Therefore, Anne’s 2001 federal income tax is $3,596 as shown below.

85
LUMP-SUM PAYMENTS FOR RETROACTIVE SOCIAL SECURITY BENEFITS

The taxable part of a lump-sum (retroactive) payment of benefits received in 2001 is included in 2001 income, even if the payment includes benefits for an earlier year.

**Observation.** The additional $10,000 of interest income increased Anne’s taxes by $2,175 ($3,596–$1,421). Even though Anne is in the 15% bracket, the effective marginal tax rate on the additional $10,000 is over 21%!

**Election To Report as Earlier Year.** Generally, a taxpayer’s 2001 income is used to calculate the taxable part of the total benefits received in 2001. However, the taxable part of a lump-sum payment for an earlier year may be calculated separately, using the taxpayer’s income for the earlier year. A taxpayer can elect this method if it lowers his or her taxable social security benefits.

Under the lump-sum election method, the taxable part of the taxpayer’s benefits for the earlier year (including the lump-sum payment) is calculated using that year’s income. Then any taxable benefits for that year that were previously reported are subtracted. The remainder is the taxable part of the lump sum payment and is added to the taxable part of social security benefits for 2001.

**Practitioner Note.** Don’t confuse this lump-sum benefit payment with the lump-sum death benefit paid by social security to the surviving spouse. That death benefit is not taxable.

Worksheets for this calculation are available in IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*. The lump-sum election can be revoked only with the consent of the Internal Revenue Service. Form SSA-1099 shows the lump-sum payment broken down by the applicable years for the settlement. Form RRB-1099 does not show a breakdown by year. Contact the Railroad Retirement Board for the appropriate amount per year.

See the Retirement chapter for a comprehensive example on lump-sum payments of retroactive social security benefits.

**REPAYMENTS MORE THAN GROSS BENEFITS**

In some situations, Form SSA-1099 or Form RRB-1099 will show that the total benefits repaid (box 4) are more than the gross benefits (box 3) received. If this occurs, the net benefits in box 5 will be a negative figure, and none of the benefits will be taxable. If the taxpayer receives more than one form, a negative figure in box 5 of one form is used to offset a positive figure in box 5 of another form for that same year. If a joint return is filed, the negative and positive figures in box 5 from both spouses’ Forms SSA-1099 or Forms RRB-1099 are netted.
Repayment of Benefits Received in an Earlier Year. If the total amount (shown in box 5) of the combination of all a taxpayer’s (and spouse’s if a joint return) benefits is a negative figure, the taxpayer can take an itemized deduction for the amount of the negative figure that represents benefits included in gross income in an earlier year.

If this deduction is $3,000 or less, it is subject to the 2%-of-adjusted-gross-income limit and is claimed on line 22 of Schedule A (Form 1040).

If the deduction is more than $3,000, the tax should be calculated in two ways:

1. Calculate the tax for 2000 with the itemized deduction. This more-than-$3,000 deduction is not subject to the 2%-of-adjusted-gross-income limit that applies to certain other miscellaneous itemized deductions.

2. Calculate the tax for 2000 as follows:
   a. Figure the tax without the itemized deduction.
   b. For each year after 1983 for which part of the negative figure represents a repayment of benefits, refigure taxable benefits as if the taxpayer’s total benefits for the year were reduced by that part of the negative figure. Then recalculate the tax for that year.
   c. Subtract the total of the recalculated tax amounts in (b) from the total of the actual tax.
   d. Subtract the result in (c) from the result in (a).

Compare the tax calculated in methods (1) and (2). The tax for 2001 is the smaller of the two amounts. If method (1) results in less tax, take the itemized deduction on line 27, Schedule A (Form 1040). If method (2) results in less tax, claim a credit for the applicable amount—the amount calculated in 2(c)—on line 63 of Form 1040 and write “I.R.C. §1341” in the margin to the left of line 63. If both methods produce the same tax, deduct the repayment on line 27, Schedule A (Form 1040).

Practitioner Note. See page 305 in the 1996 Farm Income Tax Workbook for an example of this issue.

RAILROAD RETIREMENT BENEFITS

Part of the tier 1 railroad retirement benefits are treated the same as Social Security benefits. They are the part of tier 1 benefits that a railroad employee or beneficiary would have been entitled to receive under the social security system. They are commonly called the social security equivalent benefit (SSEB) portion of tier 1 benefits.

The Form RRB-1099 reports as separate items both the SSEB portion and the other portion of railroad retirement benefits, which is taxed as normal retirement income.

VOLUNTARY WITHHOLDING

Taxpayers who receive social security benefits or tier 1 railroad retirement benefits may request that federal income tax be withheld by completing Form W-4V, Voluntary Withholding Request.

The taxpayer may choose to have federal income tax withheld at 7%, 15%, 28%, or 31% of benefits received. The form is filed with the payer of the benefits.

UNDER 65— EARNINGS STILL RESTRICTED FOR 2001

Although the earnings cap for those working and drawing social security benefits was eliminated as of January 2000 for those age 65 and over, the restriction still applies to workers under age 65.

In 2001, a retiree under 64 years old may earn $890 a month ($10,680 a year) without affecting social security benefits. Taxpayers under 64 lose $1 of benefits for every $2 of earnings above the ceiling.

During the months a retiree is 64 in the year the retiree turns 65 he or she can earn income of $2,084 per month ($25,000 a year). There is no longer a limit on earnings beginning the month the retiree turns 65.
WHEN IS A TAXPAYER CONSIDERED TO BE AGE 65?
A taxpayer must be age 65 or over to receive various tax benefits intended for older Americans. Taxpayers are considered 65 on the day before their 65th birthday.

Example 13. A taxpayer born January 1, 1937 will actually “turn 65” on January 1, 2002. However, for federal income tax purposes, that taxpayer is considered to be 65 as of December 31, 2001—and eligible for the benefits available to older taxpayers on his or her 2001 federal income tax return.

Special Payments after Retirement. In some cases, special payments are received for work done prior to the time that the individual began drawing benefits. Usually these payments do not affect benefits if the Social Security Administration knows that the payments are for work done prior to retirement. Bonuses, vacation pay, commissions, accumulated sick pay, and carryover crops might fall in this category. Although such payments are taxable for federal income tax purposes, they normally do not count as earned income toward the earnings limit for drawing full benefits.

To eliminate confusion concerning carryover grain sales made by retired farmers, the following rule has been established:

Grain sales are excluded from earnings from self-employment for purposes of reducing social security benefits if both of the following conditions are met:

1. The grain was produced and in storage before or during the first month the individual begins drawing benefits.
2. The grain is sold in a year after the first year the individual draws social security benefits [see 20 CFR 404.429(b)(2)(ii)(A)].

Practitioner Note. These carryover grain sales must be reported on Schedule F (Form 1040) and are subject to self-employment tax. Similarly, the rules apply to self-employed professionals relative to accounts receivable that are collected following retirement.

WHEN WILL TAXPAYERS BE ELIGIBLE TO DRAW FULL BENEFITS?
If a taxpayer was born in 1937 or earlier, he or she is part of the last group of people who can retire with full benefits at age 65.

<table>
<thead>
<tr>
<th>Worker Born in:</th>
<th>Age to Collect Full Benefits:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1938</td>
<td>65 years, 2 months</td>
</tr>
<tr>
<td>1939</td>
<td>65 years, 4 months</td>
</tr>
<tr>
<td>1940</td>
<td>65 years, 6 months</td>
</tr>
<tr>
<td>1941</td>
<td>65 years, 8 months</td>
</tr>
<tr>
<td>1942</td>
<td>65 years, 10 months</td>
</tr>
<tr>
<td>1943 through 1954</td>
<td>66 years, 0 months</td>
</tr>
<tr>
<td>1955</td>
<td>66 years, 2 months</td>
</tr>
<tr>
<td>1956</td>
<td>66 years, 4 months</td>
</tr>
<tr>
<td>1957</td>
<td>66 years, 6 months</td>
</tr>
<tr>
<td>1958</td>
<td>66 years, 8 months</td>
</tr>
<tr>
<td>1959</td>
<td>66 years, 10 months</td>
</tr>
<tr>
<td>1960 and later</td>
<td>67 years, 0 months</td>
</tr>
</tbody>
</table>

QUICK POINTS ON SOCIAL SECURITY

Timing of benefit checks. Individuals already receiving benefits prior to May 1997 are paid on the third of the month. If the third falls on a Saturday, Sunday, or Monday holiday, the payment is made on the
preceding Friday. For individuals who begin drawing benefits after April 1997, checks are paid based on the birth date of the individual on whose account the checks are based.

<table>
<thead>
<tr>
<th>Date of Birth:</th>
<th>Benefits Paid on:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st-10th</td>
<td>Second Wednesday</td>
</tr>
<tr>
<td>11th-20th</td>
<td>Third Wednesday</td>
</tr>
<tr>
<td>21st-31st</td>
<td>Fourth Wednesday</td>
</tr>
</tbody>
</table>

1. Social security provides the equivalent of a $198,000 disability policy and a $313,000 life insurance policy for the average earner with a family of four.

2. The average monthly Social Security benefits being received for 2001 are:

- Retired worker $845
- Retired worker & spouse $1,410
- Disabled worker $786
- Disabled worker, spouse, & children $1,310
- Widow(er) of worker $811
- Widow(er) with two children $1,696

3. The social security toll-free number is: 800-772-1213.

Wage earners and self-employed individuals earn one-quarter credit for each $830 of earnings in 2001, for up to four quarters per year.

V. MEDICARE BENEFITS

MEDICARE BASICS

The Health Care Financing Administration (HCFA) administers Medicare, the nation’s largest health insurance program, which covers 39 million Americans.

Medicare is a health insurance program for people 65 years of age and older, some disabled people under 65 years of age, and people with end-stage renal disease (permanent kidney failure treated with dialysis or a transplant). Medicare coverage includes Part A (Hospital Insurance) and Part B (Medical Insurance). Taxpayers should account for medical expenses that were not reimbursed by or paid by Medicare or third-party health insurance that may allow a medical deduction subject to the 7.5% floor on Schedule A.

Part A (Hospital Insurance) covers the following:

Hospital stays. Semiprivate room, meals, general nursing, and other hospital services and supplies. The patient is responsible for

- First $792 as a deductible for a hospital stay of 1–60 days
- $198 per day for days 61–90 of a hospital stay
- $396 per day for days 91–150 of a hospital stay
- All costs for each day beyond 150 days

Skilled nursing facility care. Semiprivate room, meals, skilled nursing, rehabilitative services, and other services and supplies (after a three-day hospital stay).
The patient is responsible for:
- No additional charge for the first 20 days
- Up to $99 per day for days 21–100
- All costs beyond the hundredth day in the benefits period

Home health care. Part-time skilled nursing care, physical therapy, speech-language therapy, home health aide services, and durable medical equipment and supplies.

The patient is responsible for:
- No additional charge for home health care services
- 20% of approved amount for durable medical equipment

Hospice care. Medical and support services from a Medicare-approved hospice, drugs for symptom control and pain relief, short-term respite care, and care in a hospice facility, hospital, or nursing home when necessary.

The patient is responsible for:
- A co-payment of up to $5 for outpatient prescription drugs and 5% of the Medicare payment amount for inpatient respite care (short-term care given to a hospice patient by another care-giver so that the usual caregiver can rest)

Blood. Given at a hospital or skilled nursing facility during a covered stay.

The patient is responsible for:
- The first three pints of blood

**Part B (Medical Insurance) covers the following:**

Medical and other services. Doctor’s services (except for routine physical exams), outpatient medical and surgical services and supplies, diagnostic tests, ambulatory surgery center facility fees for approved procedures and durable medical equipment, and outpatient physical and occupational therapy including speech-language therapy and mental health services.

The patient is responsible for:
- $100 deductible (paid once per calendar year)
- 20% of approved amount after the deductible, except in the outpatient setting
- 20% for all outpatient physical and speech therapy services and 20% for all outpatient occupational therapy services
- 50% for most outpatient mental health services

Clinical laboratory services. Blood, urinalysis, and so on.

The patient is responsible for:
- No additional charge for services

Home health care. Part-time skilled care, home health aide services, durable medical equipment when supplied by a home health agency while getting Medicare-covered home health care, and other supplies and services.

The patient is responsible for:
- No additional charge for services
- 20% of approved amount for durable medical equipment

Outpatient hospital services. Services for the diagnosis or treatment of an illness or injury.
The patient is responsible for

- 20% of the charged amount (after the deductible); during the year 2000, this will be changed to a set co-payment amount

Blood. Pints of blood needed as an outpatient, or as part of a Part B-covered service.

The patient is responsible for

- The first three pints of blood, then 20% of the approved amount for additional pints of blood (after the deductible)

VI. TAX CREDITS

CREDIT FOR THE ELDERLY OR DISABLED

The credit for the elderly or disabled is for low-income taxpayers age 65 or older, or for permanently and totally disabled persons.

The credit is claimed by filing Schedule R, Credit for the Elderly or Disabled. Nontaxable social security must be less than $7,800 for married filing jointly if both spouses are eligible. Adjusted gross income may not exceed the following:

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, Head of Household, Qualifying Widow(er)</td>
<td>$17,500</td>
</tr>
<tr>
<td>Married Filing Jointly (one spouse eligible)</td>
<td>20,000</td>
</tr>
<tr>
<td>Married Filing Jointly (both spouses eligible)</td>
<td>25,000</td>
</tr>
<tr>
<td>Married Filing Separately (lived apart entire year)</td>
<td>12,500</td>
</tr>
</tbody>
</table>

Who Qualifies for the Credit?

1. Persons age 65 or older.
2. Persons under 65 who are retired because of permanent and total disability and meet the following criteria:
   - a. Received taxable disability income
   - b. Did not reach mandatory retirement age before the tax year (mandatory retirement age is the age set by the employer at which the individual would have had to retire had he or she not been disabled)
3. Must be a U.S. citizen or resident (in most cases)
4. If married at the end of the year, must normally file a joint return, unless the taxpayers did not live together at any time during the year

What is Permanent and Total Disability? A taxpayer is permanently and totally disabled if he or she cannot engage in any substantial gainful activity because of a physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months, or that the condition can be expected to result in death.

What is Substantial Gainful Activity? Substantial gainful activity is the performance of significant duties over a reasonable period of time while working for pay or profit, or in work generally done for pay. Full-time work (or part-time work done at the employer’s convenience) in a competitive work situation for at least the minimum wage conclusively shows that the taxpayer is able to engage in substantial gainful activity.
Substantial gainful activity is not work the taxpayer does to take care of himself or herself or to take care of the taxpayer’s home. It is not unpaid work on hobbies, institutional therapy or training, school attendance, clubs, social programs, and similar activities. However, doing this kind of work may show that the taxpayer is able to engage in substantial gainful activity.

**Example 14:** Miss Ima Jean Teacher (69) is a retired school teacher. Her income is derived from the following:

- $1,000 interest
- $11,000 teacher’s retirement
- ($3,000) capital loss from sale of a mutual fund
- $2,400 social security benefits

See completed Schedule R. Miss Teacher has a maximum credit of $278. Miss Teacher’s taxable income is $450 and her income tax liability is $45, which is “paid” by the Credit for the Elderly. The balance is not refundable.
11 If you checked:
   ● Box 6 in Part I, add $5,000 to the taxable disability income of the spouse who was under age 65. Enter the total.
   ● Box 2, 4, or 9 in Part I, enter your taxable disability income.
   ● Box 5 in Part I, add your taxable disability income to your spouse’s taxable disability income. Enter the total.

For more details on what to include on line 11, see page R-3.

12 If you completed line 11, enter the smaller of line 10 or line 11; all others, enter the amount from line 10.

13 Enter the following pensions, annuities, or disability income that you (and your spouse if filing a joint return) received in 2001:
   a Nontaxable part of social security benefits and Nontaxable part of railroad retirement benefits treated as social security. See page R-3. 13a 2,400
   b Nontaxable veterans’ pensions and Any other pension, annuity, or disability benefit that is excluded from income under any other provision of law. See page R-3. 13b
   c Add lines 13a and 13b. (Even though these income items are not taxable, they must be included here to figure your credit.) If you did not receive any of the types of nontaxable income listed on line 13a or 13b, enter -0- on line 13c. 13c 2,400

14 Enter the amount from Form 1040, line 34. 14 9,000

15 If you checked (in Part I): Enter:
   Box 1 or 2 7,500 15 7,500
   Box 3, 4, 5, 6, or 7 10,000
   Box 8 or 9 5,000

16 Subtract line 15 from line 14. If zero or less, enter -0-. 16 1,500

17 Enter one-half of line 16. 17 750

18 Add lines 13c and 17. 18 3,250

19 Subtract line 18 from line 12. If zero or less, stop; you cannot take the credit. Otherwise, go to line 20. 19 1,850

20 Multiply line 19 by 15% (.15). Enter the result here and on Form 1040, line 45. But if this amount is more than the amount on Form 1040, line 42, minus any amount on line 43, or you are filing Form 2441, see page R-3 for the amount of credit you may take. 20 278

Schedule R (Form 1040) 2001

CHILD AND DEPENDENT CARE CREDIT

Care for a Dependent Parent. The same credit that is available for parents who pay someone to care for a child or children under age 13 so that the parents can work is available for the care of a spouse or dependent (possibly an elderly parent) who is not able to care for himself or herself.

The credit can be up to 30% of the expenses paid so that the taxpayer can work or look for work. The individual for whom the taxpayer provides care must live in the same home as the taxpayer. The credit is not available for money paid to the taxpayer’s spouse, a person the taxpayer can claim as a dependent, or to the tax-payer’s child who is under age 19 at the end of the year.

The individual for whom the taxpayer provides care for must be eligible to be claimed as a dependent on the taxpayer’s return. There is an exception for a person who is physically or...
mentally unable to care for himself or herself and could be claimed as a dependent on the taxpayer’s return were it not for the gross income limitation.

To claim the credit, **file Form 2441** with the tax return and include the care provider’s name, address, tax identification number, and the amount paid, as well as the name and tax identification number of the person for whom care is provided.

Note that the dependent care credit is available to married couples living together in the same household only if they file jointly.

The credit on which the expense is based is limited to the earned income of the lower-earning spouse. There is an exception for a student or disabled spouse: If one spouse is a full-time student or one spouse is disabled, you can count that person as having made $200 per month with one qualifying individual and $400 per month with two or more qualifying individuals to care for.

**EARNED INCOME CREDIT**

Although we do not normally think of the earned income credit (EIC) in connection with older taxpayers, there are at least two possible applications.

1. Many grandparents are now raising grandchildren. If they qualify for the earned income credit, the same rules will apply to them as apply to parents.

2. If there are no qualifying children, the couple may be eligible for the limited earned income credit if the following conditions are met:

   - Modified AGI and earned income must be less than $10,710 (2001 figure).
   - Taxpayer must be at least 25 years old but **less than 65** at the end of the year.
   - Taxpayer cannot qualify as a dependent on any other return.
   - On a joint return, only one spouse must be under age 65 to qualify for limited EIC.

**SOURCES OF INFORMATION**

**IRS publications**

*Older American’s Tax Guide*—Publication 554

*Insurance Proceeds*—Publication 525

*Annuities*—Publication 575

*Social Security and Equivalent Railroad Retirement Benefits*—Publication 915

**Web sites**

Medicare Web site: www.medicare.gov

Medicaid Web site: www.hcfa.gov

Social Security Web Site: www.ssa.gov

AARP Web Site: www.aarp.org

**Private publications**

*RIA Federal Tax Handbook 2001*

*Tax Analyst OneDisc*

*Tax Facts I*, Publication of the National Underwriter Company

*The Long Term Care Handbook* by Jeff Sadler

*Long-Term Care Insurance Tax Guide*, TransAmerica Insurance

*Long Term Care Insurance: A Guide to Tax Issues*, UNUM Life Insurance