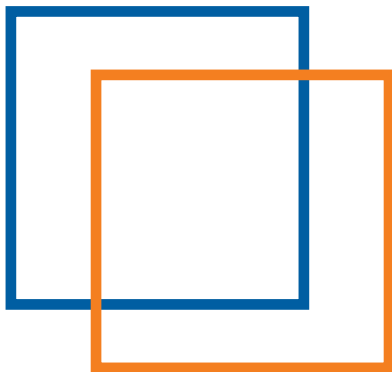

Medical Expenses

The Guide to Select Overlooked
Medical Deductions



An Exclusive Special Report from
BradfordTaxInstitute.com

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How to Reimburse Medicare When You Have Fewer Than 20 Employees

In this article, first we expand the Medicare reimbursement group from the C corporation to all employers with fewer than 20 employees (proprietorships, partnerships, S corporations, and C corporations).

Second, we take the tortuous language in TD 9477 that allows the Medicare reimbursement without worry of the \$100-a-day penalty and put it into plain English so you can put it to use.¹

Signing Up for Medicare

Don't be late. Here's a heads-up: If you are nearing Medicare age, you can suffer big Medicare penalties if you sign up for Medicare late. Here's how the Medicare website explains the penalty:²

In most cases, if you don't sign up for Part B when you're first eligible, you'll have to pay a late enrollment penalty. You'll have to pay this penalty for as long as you have Part B. Your monthly premium for Part B may go up 10% for each full 12-month period that you could have had Part B, but didn't sign up for it.

To ensure your understanding, the Medicare website gives you this example:³

Your Initial Enrollment Period ended December 2016. You waited to sign up for Part B until March 2019 during the General Enrollment Period. Your coverage starts July 1, 2019. Your Part B premium penalty is 20%, and you'll have to pay this penalty for as long as you have Part B. (Even though you weren't covered a total of 27 months, this included only 2 full 12-month periods.)

To clarify: if this were you in the penalty box above, Medicare would add 20 percent to your Medicare Part B cost every year.

For example, if your Medicare cost without penalty is \$5,000, your penalty is \$1,000, and your cost for the year is \$6,000. For the next year, if your Medicare cost is \$6,000, your penalty is \$1,200, and your cost for the year is \$7,200.

So, don't be late. You can enroll in Medicare beginning three months before the month during which you turn age 65.⁴ If you have employer insurance coverage, you can delay your Part B without penalty in certain circumstances.

Fly in the Ointment

Some group insurance plans do not cover Medicare-eligible employees if the group plan covers fewer than 20 employees, because:

- With fewer than 20 employees, Medicare is the primary payer and the insurance company is secondary.
- With 20 or more employees, Medicare is the secondary payer and the insurance company is primary.

Alerts

Employer. If you are an employer with fewer than 20 employees, the Medicare secondary payer rules come into play, and those rules do not require you to offer group health insurance to your Medicare-eligible employees.⁵ Because of this Medicare rule, the IRS allows you to reimburse Medicare without worry of the \$100-a-day penalty, as we explain below.

Employee. If you are a Medicare-eligible employee who's not going to obtain health insurance through the group plan, make sure you have your Medicare coverages in place.

No \$100-a-day penalty. Without the fewer-than-20-employees rule for reimbursing Medicare as explained below, you (the employer) would be looking at the \$100-a-day penalty for reimbursing Medicare.⁶

Reimbursing Medicare

If you (a) offer group insurance coverage to your fewer-than-20-employee workforce, and (b) have one or more of the fewer than 20 employees on Medicare, you may use a health reimbursement account (HRA) or other account-based plan to reimburse Medicare parts B and/or D and Medigap insurance, if you satisfy the following requirements:⁷

1. You offer a group health plan to employees who are not eligible for Medicare.⁸
2. The employee receiving the HRA or other account-based Medicare reimbursement plan is actually enrolled in Medicare part B or D.⁹
3. You make the HRA or other account-based Medicare reimbursement plan available only to employees who are enrolled in Medicare part B or D.¹⁰
4. You permit the Medicare employee to permanently opt out of and waive future reimbursements from the HRA or other account-based plan at least annually and upon termination of employment.¹¹

Sample Plan

We created a sample “Medicare Health Reimbursement Account Plan” document for your use. To access the sample plan, [click here](#).

Takeaways

When you become eligible for Medicare, sign up. Don't procrastinate.

If you (the employer) have fewer than 20 employees, make sure you know what happens to Medicare-eligible employees with your group health plan coverage.

If you have fewer than 20 employees and want to reimburse your Medicare-eligible employees for their costs of Medicare, consider using our [sample HRA plan document](#) and make sure to do the following:

- **For employees not eligible for Medicare:** Offer group health plan coverage.
- **For employees eligible for Medicare:** Offer the Medicare reimbursement HRA.

¹ TD 9744. You can find the tortuous language on Federal Register p. 72202, column 3.

² <https://www.medicare.gov/your-medicare-costs/part-b-costs/part-b-late-enrollment-penalty>.

³ Ibid.

⁴ <https://www.medicare.gov/sign-up-change-plans/getting-started-with-medicare>.

⁵ TD 9744, Federal Register, ps. 72202, 72203.

⁶ IRC Section 4980D.

⁷ Reg. Section 54.9815-2711(d)(5).

⁸ Reg. Section 54.9815-2711(d)(5)(i).

⁹ Reg. Section 54.9815-2711(d)(5)(ii).

¹⁰ Reg. Section 54.9815-2711(d)(5)(iii).

¹¹ Reg. Sections 54.9815-2711(d)(5)(iv); 54.9815-2711(d)(2)(i)(E); 54.9815-2711(d)(2)(ii)(D).

Special Needs Education Can Qualify as a Business Expense—Here's How

Let's say that you have a child with some learning disabilities that can be substantially (possibly totally) overcome if he attends the Lab School of Washington, located in Washington, D.C. The tuition alone is about \$45,000.

You would think that with all the emphasis on health care, you could simply deduct the cost from your taxes. That's not so. In fact, your ability to deduct medical costs on your Form 1040 has dwindled in recent years.

Let's just call the Form 1040 itemized medical deduction a poor second choice.

The first choice is the one-employee health reimbursement arrangement (HRA) that's exempt from the Affordable Care Act. This plan could allow you to deduct the entire cost of your child attending the Lab School and obtaining the proper therapy.

In this article, we are going to call this plan the 105-HRA to identify the tax code section that makes it available and distinguish it from other HRAs, such as the QSEHRA that we explained last month. To put this 105-HRA to work for you, you have to meet or create the right circumstances in your business.

Will the 105-HRA Work for Me?

The 105-HRA plan is a one-employee plan.

If you operate your business as a proprietorship or single-member LLC taxed as a proprietorship, you are not an employee of that business. This means no 105-HRA for you.

But what if you are married? Could your spouse be your one and only employee? If so, you have the beginnings of a solution and possibly the entire solution.

But what if you are single? In this case, you need a C corporation so you can be the only employee of the C corporation.

So your ability to create the 105-HRA to turn your high medical costs into tax-favored business deductions requires the one magic employee (you or your spouse) and the right form of business as follows:

- Proprietorship—no eligible employees other than your spouse
- Single-member LLC—no eligible employees other than your spouse

- C corporation—no eligible employees other than you or you and your spouse if you both work in the C corporation

Community property states. If you and your spouse operate an LLC that's taxed as a partnership in a community property state, you can elect taxation as a single-member LLC.

Discrimination

If you have employees, your ability to generate the monies for the Lab School are substantially reduced for a variety of reasons, including a cap on benefits with a QSEHRA or big expenses with an integrated HRA.

So the first question: Do you really have employees whom you have to cover with the 105-HRA? There are many workers you can exclude from your 105-HRA, including employees:

- with less than three years of service on the plan date,
- who have not attained age 25 at the plan date,
- who customarily work less than 25 hours a week, or
- who customarily work less than seven months during the year.

Perhaps now you have far fewer employees than you first thought when considering this plan.

Reasonable Compensation

When the spouse is your only employee and you have a high-value 105-HRA, you need to ensure that the value of the plan and the W-2 wage, if any, represent reasonable compensation.¹

And you want some type of proof, such as the compensation listed in a salary guide. If you Google “salary guide 2019,” you likely will find some guides you can use. Once you have something on which you can hang your hat, make a photocopy or scan and put it in your tax file so it's there should you need it.

And keep in mind that the compensation has to be reasonable, not perfect.

Let's say that you are going to pay your spouse \$65,000—\$5,000 in W-2 wages and \$60,000 in 105-HRA medical reimbursement. If your spouse works:

- 2,080 hours a year, the total \$65,000 pay package comes out to \$31.25 an hour
- 750 hours a year, that's \$86.67 an hour or about \$180,000 a year when annualized

Both numbers are possible depending on the work your spouse does, but with either number, you need proof that the pay package to your spouse is reasonable.

If you have a C corporation and it's paying you as its only employee eligible for the 105-HRA, the reasonableness of your total pay package can also be an issue, but first, that's less likely, and

second, there's more latitude in your pay package because you are the owner-employee, the mover-shaker.

Child's Medical Care

The 105-HRA plan allows you to cover the expenses of your dependents, including children up to age 27.² Children with special needs, even above age 27, may also still qualify as dependents.

105-HRA or Itemized Deduction

Regardless of your ability to use the 105-HRA or if you have to claim the expenses as itemized deductions, you need to know the rules below to ensure your best available tax benefits and protect yourself in an IRS audit.

Defining "Special Needs" School

The education costs of mentally or physically challenged individuals qualify as medical expenses if the primary purpose of the school they attend is to enable students to compensate for or overcome those challenges.³

Other education at the school will not disqualify the expenses as long as the other education is incidental to the school's primary purpose.⁴

Several types of schools qualify, including but not limited to those that

- teach Braille to the blind or lip reading to the deaf,⁵
- offer special programs for children with severe learning disabilities,⁶ or
- provide an environment in which intellectually or physically challenged students can adjust to a mainstream classroom situation.⁷

Deductible Expenses

Lawmakers are surprisingly generous regarding which schooling expenses you can deduct. You'll find that most, if not all, the additional costs for special needs schooling are deductible medical expenses that you can deduct as itemized deductions or reimburse with the 105-HRA, making them business expenses. These include the following:

- Tuition⁸
- Meals that the school provides⁹
- Lodging that the school provides¹⁰
- Transportation to and from school¹¹

Doctor's Note

The IRS has stated in several rulings that a key factor it looks for in determining whether school expenses qualify as medical expenses is that a doctor recommended that the child attend the school.¹²

You would like to think that the IRS would not question the legitimacy of your child's need to attend one of these schools—but you simply can never be sure when the IRS is involved. So get what the IRS likes to see: a doctor's note stating the need for your child's special education.

Takeaways

Schooling for a special needs student can be extremely costly. Fortunately, tax law gives you a break by allowing you to treat those costs as deductible medical expenses.

As a business owner in the right circumstances, you can turn your medical expenses into tax-favored business deductions if you can make use of the 105-HRA. To make this happen, you need one eligible employee and no other eligible employees. And you want that eligible employee to be either you or your spouse.

Remember, as a proprietor or single-member LLC taxed as a proprietor, you are not an employee. To make the 105-HRA work for you in these cases, you need an employee-spouse and no other eligible employees.

Below we have a 105-HRA sample plan for your use in either PDF or Word format.

- For PDF format, [click here](#).
- For Word format, [click here](#).

For your child's special needs education costs to qualify as medical expenses, the school's primary purpose must be to teach students how to compensate for or overcome a handicap. To help ensure your tax deductions for this schooling, obtain a doctor's recommendation for the child to attend the school. While this isn't a tax law requirement, it's a big help should you have to discuss this deduction with the IRS.

¹ IRS Industry Specialized Program (ISP) Settlement Guideline for Health Insurance Deductibility for Self-Employed Individuals (UIL No. 162.35-02) Factual issue, January 25, 2001.

² See IRC Section 105(b).

³ Reg. Section 1.213-1(e)(1)(v)(a).

⁴ Rev. Rul. 70-285.

⁵ Reg. Section 1.213-1(e)(1)(v)(a).

⁶ Rev. Rul. 78-340.

⁷ PLR 200729019.

⁸ Reg. Section 1.213-1(e)(1)(v)(a); *Greisdorf v Commr*, 54 TC 1684.

⁹ Reg. Section 1.213-1(e)(1)(v)(a).

¹⁰ *Id.*

¹¹ Rev. Rul. 70-285.

¹² Rev. Rul. 78-340.

Can Your Emotional Support Animal Take a Bite Out of Your Taxes?

Animals are the best, aren't they? Warm, cuddly, loyal—just fabulous companions in general. For some of you, though, they're much, much more.

You may depend on your animals for the emotional support you need to simply do your job and get through the day. If you struggle with depression, anxiety, or another mental illness or disability, emotional support animals can provide important comfort and assistance.

But that's not all your animal can do for you. If it qualifies as a bona fide medical expense, you could claim that expense as part of your Section 105 medical plan or a flexible spending plan (if you have such a plan in place) or as an itemized deduction.

Really—that's the doggone truth!

Deducting Your Medical Expenses

You generally deduct the costs of a qualifying psychiatric support animal as a medical expense in one of three ways:

1. As itemized deductions
2. As employee welfare benefits if you have a Section 105 or other established health reimbursement account
3. Using the benefits of a flexible spending account

The tax code allows you to deduct the expenses you pay for the medical care of you, your spouse, and your dependents.¹ To qualify for the deductions, your expenses have to get over two hurdles.

Hurdle 1: The “Primarily for” Test

The IRS confines deductions for medical care to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.²

You fail the “primarily for” test when you take a vacation, even on doctor's orders, that's merely beneficial to your general health.³

Whether an otherwise personal expense qualifies as “primarily for” medical care depends on the specific circumstances, such as:⁴

- your reason for the expense,

- whether you incurred the expense on the advice of a physician,
- the link between the expense and the medical condition,
- the effectiveness of the expense as treatment, and
- how close in time to the onset or recurrence of the condition you incur the expense.

Hurdle 2: The “But for” Test

It’s a funny name, but it’s no joke. You can’t deduct a personal expense for medical care if you would have had the expense even without the medical condition.⁵

For example, the Tax Court rejected a depressed taxpayer’s medical expense claim for the legal costs of getting a divorce recommended and attested to in court by his psychiatrist. The taxpayer failed the “but for” test. The court said it believed that he would have divorced his wife regardless of his depression.⁶

Psychiatric Service Animals Can Qualify as Deductible Medical Expenses

Now let’s get down to the nitty gritty: We know expenses for the cost and care of service animals that help people with *physical* disabilities can count as medical expenses,⁷ but what about animals that help people with *mental* disabilities? Can they qualify?

According to an IRS information letter, the answer is a big, fat yes!

In Info Letter 2010-0129, the IRS clearly stated that the costs of buying, training, and maintaining a service animal to assist an individual with mental disabilities can qualify as deductible medical care if the taxpayer can pass both (a) the “primarily for” test and (b) the “but for” test.⁸

So if you bought a psychiatric service animal this year on a doctor’s advice or have had expenses for such an animal’s food, grooming, or veterinary care—basically anything to maintain its health and vitality so it can do its job⁹—those costs are potentially deductible.

Dog

The Code of Federal Regulations under the Americans with Disabilities Act of 1990 (ADA) says that a “service animal” is a dog.¹⁰ This can cause confusion until you remember that the disability law is not the tax law.

With public law 100-647, lawmakers adopted a Senate amendment clarifying that costs incurred with respect to a “dog or other service animal” that assists individuals with any type of physical disabilities are eligible for the medical expense deduction.¹¹ Note that the Senate included “other service animal” in its legislation that the lawmakers adopted.

The IRS in private letter ruling 8033038 allowed the taxpayer to deduct as a medical expense the costs of maintaining a cat that helped alleviate the effects of a severe hearing impairment.¹²

Although the disabilities act is not tax law, it does give you additional support for a dog deduction when the dog qualifies as a service animal under federal disability rules.

Dogs That Qualify as ADA Service Animals

Not just any dog will do. Unless your dog has been individually trained to do work or perform tasks that help with your disability, it isn't an ADA service animal.¹³

For psychiatric and neurological disabilities, a dog's work might include:

- preventing or interrupting impulsive or destructive behaviors,¹⁴
- sensing that an anxiety attack is about to happen and taking a specific action to help avoid the attack or reduce its effect,¹⁵
- calming a person with PTSD during an anxiety attack,¹⁶ or
- reminding a person with mental illness to take prescribed medications.¹⁷

Unfortunately, providing emotional support, well-being, comfort, or companionship—no matter how important to your mental health—doesn't count for the ADA.¹⁸ But it could count for tax purposes.

Making a Claim That Will Hold Up

Ideally, you have an ADA psychiatric service dog (not “just” an emotional support animal). If so, you have greatly improved your chances of a deduction.

Here are three additional tips:

1. Get a doctor's diagnosis and a prescription or at least a recommendation for the dog to treat or mitigate the diagnosed condition.
2. Make sure you have documentation of:
 - the effectiveness of psychiatric service dogs for your condition,
 - the individual training your dog has had (you can do it yourself—you don't need to use a professional¹⁹), and
 - the work or tasks the dog does for you.
3. Prepare to show you wouldn't have had the expense “but for” the condition. In other words, if you didn't have the mental condition, you wouldn't have the dog. In fact, the ideal is that you buy the dog after the doctor prescribes your need for the dog.

If the dog does not meet the ADA definition of a service animal, it can still qualify as a medical deduction depending on its facts and circumstances. Similarly, if you have a service animal other than a dog, such as the cat we found in the private letter ruling, you may qualify to deduct the cost of the animal and the cost of its care.

Takeaways

Your emotional support dog (or other service animal) might qualify as a medical expense deduction. If it's a dog trained to help with your condition, it's found in the ADA rules, and you have a doctor's prescription for the dog, your chances of a deduction are much improved.

Information letter 2010-0129 sets the standard as follows:

The costs of buying, training, and maintaining a service animal to assist an individual with mental disabilities may qualify as medical care if the taxpayer can establish that the taxpayer is using the service animal primarily for medical care to alleviate a mental defect or illness and that the taxpayer would not have paid the expenses but for the disease or illness.

You can condense this test to whether you bought the service animal “primarily for” medical care and would not have bought the animal “but for” your medical condition. You need to prove both (a) primarily for and (b) but for.

¹ IRC Section 213(a).

² Reg. Section 1.213-1(e)(1)(ii).

³ Ibid; Havey v Commr., 12 T.C. 409.

⁴ IRS Info. Letter 2010-0129 (June 25, 2010); Havey v Commr., 12 T.C. 409.

⁵ IRS Info. Letter 2010-0129 (June 25, 2010); Jacobs v Commr., 62 T.C. 813.

⁶ Jacobs v Commr., 62 T.C. 813.

⁷ IRS Publication 502, Medical and Dental Expenses (2018), Dated Jan. 9, 2019, p. 8.

⁸ IRS Info. Letter 2010-0129 (June 25, 2010).

⁹ IRS Publication 502, Medical and Dental Expenses (2018), Dated Jan. 9, 2019, p. 8.

¹⁰ 28 C.F.R. Part 36, Section 36.104.

¹¹ Technical and Miscellaneous Revenue Act of 1988, Conference Report to Accompany H.R. 4333, 100th Congress, 2d Session, Rpt. 100-1104, p. 138.

¹² Private Letter Ruling 8033038.

¹³ U.S. Department of Justice, Frequently Asked Questions About Service Animals and the ADA, Dated July 20, 2015, p. 2.

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ U.S. Department of Justice, ADA 2010 Revised Requirements: Service Animals, Dated July 12, 2011, p. 1.

¹⁷ Ibid.

¹⁸ 28 C.F.R. Part 36, Section 36.104.

¹⁹ U.S. Department of Justice, Frequently Asked Questions about Service Animals and the ADA, Dated July 20, 2015, p. 2.

How to Deduct Your Swimming Pool and Other Home Improvements as Medical Expenses—All Legal If You Do It Right

Estimated Tax Tip Savings: *A swimming pool you install for medical reasons could increase your tax deductions by \$12,000 or more, giving you a tax savings of \$3,000 or more depending on your tax bracket. Other such home improvements can be similarly deducted.*

In middle school, a note from your doctor was the perfect thing to get you out of gym class. Now that doctor's note might get you a tax-deductible swimming pool or other home improvements that allow you to increase your deductions. Here's how it works:

If you buy a pool for medical reasons, tax law gives you a deduction for the cost of installation and for operating expenses, even though technically the pool is a capital improvement of your home.

This deduction applies to all equipment that you use in your home, workplace, or vehicle for medical purposes, including¹

- ergonomic chairs;¹
- elevators;
- lift equipment for vehicles;¹
- accessibility ramps; and
- artificial limbs.

But unless you take this deduction the right way, you might not get the tax benefit you want. As you read this article, you'll see why you, as a small-business owner, are in the perfect position to maximize your tax savings.

Immediate Deduction of a Capital Expenditure

The medical expense deduction is an exception to the normal tax rule that applies when you purchase items that last more than one year (so-called capital expenditures). A well-built pool should last decades, as long as you maintain it. Contrast this with items like paper cups that you buy for the office and quickly throw away.

Under the normal tax rule, you cannot immediately deduct capital expenditures.¹ Instead, to the extent you can deduct these expenses at all, you must depreciate the cost over a period of years.

The medical expense deduction changes this rule and allows you to immediately deduct the capital expenditures you make for medical purposes.²

Here's an added bonus—there's no recapture of these expenses in later years if your medical condition improves but you continue to use the pool or other asset. In other words, there's no recapture tax or other tax to pay if you begin to use the pool for non-medical purposes in later years.

How Much to Deduct

You deduct the amount of the expenditure that exceeds the increase in the property value of the home.

For example, let's say that your pool costs \$20,000 to install and this increases the value of your home by \$8,000. This means that you can deduct \$12,000 as a medical expense (\$20,000 - \$8,000).

100 percent exception. The IRS gives you a 100 percent deduction for medical expenditures that have little purpose outside of medical treatment. Here are some examples of expenditures that qualify for the 100 percent deduction:³

- Entrance or exit ramps to the residence
- Railings, support bars, or other modifications to bathrooms
- Lowering of kitchen cabinets
- Altering of location of electrical outlets and fixtures for accessibility
- Grading of ground to provide access to the residence
- Porch lifts and other lifts (but not elevators)

Unless your pool is very specialized for medical care, you should not count on the 100 percent exception. You should deduct the pool only to the extent the cost of the pool exceeds the value increase in your home.

Full Deduction for Operating and Maintenance Expenses

Tax law gives you a full deduction for operation and maintenance expenses.⁴

You deduct these expenses every year that you continue to use the asset for medical purposes.

For example, if you have an indoor pool, you will incur costs for electricity to light the pool room and operate the cleaning equipment. You can deduct a portion of your home's electrical bill to the extent that the cost is allocable to your use of the pool.⁵

Prove the Medical Purpose

To take advantage of the medical expense deduction, you must show that the expenditure is⁶

1. used for the primary purpose of medical care and
2. directly related to medical care.

Example of Success in Court

Herbert Cherry proved in court that his pool qualified as a medical expense. The pool was

- 20 feet by 40 feet;
- heated;
- located in an indoor pool room that was about one-third the size of the total house; and
- was equipped with a diving board and no specialized medical equipment.

Mr. Cherry could deduct the pool to the extent it exceeded the increase in the value of his home.⁷ In addition, he could deduct the yearly cost of heating the pool, insurance, electricity for the pool room, and repairs for the pool room walls that had suffered mildew damage.

Proof the pool was directly related to medical care. Mr. Cherry's doctor recommended swimming to help his emphysema and bronchitis. The disease symptoms returned after five days when he could not swim regularly.

Proof of primary purpose. The court found that Mr. Cherry constructed and maintained the pool primarily for medical reasons because

- he purchased it only after his doctor's recommendation;
- he investigated less expensive alternatives before building the pool;
- he used the pool frequently (twice a day every day); and
- his wife and children used the pool only occasionally.

Example of Failure in Court

In a recent case, Charles Le Beau lost his pool deduction.⁸ The only evidence he could present to support his case was his personal testimony that his doctor had advised him to lose weight.

He could not prove the pool was directly related to medical care and did not give evidence of the pool's primary purpose.

You can probably see why Mr. Le Beau stood no chance of getting court approval for his medical deduction. In fact, the court ordered him to fork over penalties in addition to his unpaid taxes.

Courts Like Specialized Equipment

In general, you present a stronger case when you build special medical features into the pool. Specialized equipment costs extra and is not likely to increase the value of the home. This helps you prove that you are building the pool primarily for medical reasons and not for recreation.

Here are some examples of special features that helped taxpayers win their deductions in court:

- A ramp in the pool that allowed wheelchair entry⁹
- A wading pool that took up most of the taxpayer's yard¹⁰
- A shallow lap pool designed with wide steps to allow easy entry for the owner suffering from osteoarthritis¹¹

Important—Business Reimbursement Works Best

There's one more important component to maximizing your tax benefit from the medical expenditure—you don't want to claim the deduction on your personal tax return.

On your personal tax return, you can claim medical expenses only to the extent the expenses exceed 10 percent of your adjusted gross income.

How do you avoid this limit? The best option is to set up a Section 105 plan for your business. With the Section 105 plan, your business can reimburse you for the expense so that you get 100 percent of the value of the deduction.

If you do not have a Section 105 plan, you can get a similar benefit through a flexible spending account (FSA) or a health savings account (HSA). These plans are not unlimited like a Section 105 plan, so you may not get full reimbursement for big expenses. But once you get maximum reimbursement through these accounts, you can deduct the remainder on your personal return.

Example. Dave builds an elevator in his home for medical purposes. The cost of the elevator exceeds the value increase of his home by \$20,000. Dave's adjusted gross income for the year is \$180,000.

If Dave reimburses the elevator expense through his Section 105 plan, he deducts the full \$20,000. Otherwise, Dave is limited to a \$2,000 deduction on his personal return ($\$20,000 - 10\% \times \$180,000$).

Takeaways

If you have a health issue and could benefit through the purchase of medical equipment such as a pool, the medical expense deduction could be exactly the thing to help you afford it.

As a small-business owner, you are in an excellent position to make the most of this tax benefit because you can use your Section 105 plan to escape the 10 percent AGI limit on your personal return.

Whether it's a pool, a ramp to your home, or a mechanized lift for your vehicle, take advantage of the government's offer to subsidize your health care treatment. It could make a huge difference in your quality of life.

¹ IRC Section 263.

² Reg. Section 1.213-1(e)(1)(iii).

³ Rev. Rul. 87-106.

⁴ Reg. Section 1.213-1(e)(1)(iii).

⁵ *Herbert Cherry*, TC Memo 1983-470.

⁶ Reg. Section 1.213-1(e)(iii).

⁷ The construction expenditure was not at issue in the court, since the pool was built in a prior tax year not in issue. The court did decide that the pool was a Section 213 medical expenditure, which means that Mr. Cherry could have deducted the construction expense to the extent it exceeded the value increase in the house.

⁸ *Charles P. Le Beau*, TC Memo 2014-198.

⁹ *Mason v United States*, 52 AFTR 1593.

¹⁰ *Richard A. Polacsek*, TC Memo 1981-569.

¹¹ Rev. Rul. 83-33.

Turbocharge Your Retirement Savings with an HSA

You probably think of a health savings account (HSA) as simply an account to put aside money for medical expenses. After all, the name is “health savings account,” so what else would it be for?

Think again! After reading this article, you’re going to look at HSAs in a completely different light. The HSA is the Swiss Army knife of savings accounts. Not only does it provide big benefits for medical expenses, but it is also a powerful tool to supplement your retirement savings.

In fact, you will benefit more by putting money aside in an HSA rather than a traditional IRA. Yes, you read that right—an HSA provides bigger tax benefits than an IRA.

This may sound crazy to you, but we will demonstrate below just how powerful an HSA is.

Qualify for an HSA

To contribute to an HSA, you must have a high-deductible health plan.¹

For 2019, a high-deductible health plan is a plan with an annual deductible of at least \$1,350 for self-only coverage, or at least \$2,700 for family coverage.²

Additionally, the maximum annual out-of-pocket expenses the high-deductible plan can require you to pay are \$6,750 for self-only coverage, and \$13,500 for family coverage.³

A Deduction You Can Count On

The HSA and traditional IRA are similar in that you may qualify for a tax deduction when you contribute. But to qualify for the traditional IRA deduction,

- you (or your spouse, if applicable) may not actively participate in an employer retirement plan; or
- (if you or your spouse is a participant in an employer retirement plan) your contribution to the traditional IRA is limited or phased out entirely when your modified adjusted gross income exceeds \$64,000 (\$103,000 for joint filers).⁴

In contrast to the traditional IRA, your tax deduction for HSA contributions is never phased out.⁵ Whether you make \$5 or \$5 million, you always get this deduction. You fund the HSA with tax-deductible dollars.

Advantage: HSA

Tax-Free versus Tax-Deferred

Here's where things get really good with the HSA. It's possible to avoid taxes forever. You can't do that with a traditional IRA. You get a deduction when you contribute but pay taxes on the back end when you withdraw funds.⁶

With an HSA, you can withdraw funds at any time, free of federal taxes, to use for qualified medical expenses.⁷ When you reach Medicare-eligibility age (age 65), you qualify for an added benefit because you can use the HSA funds to cover your health insurance premiums, including Medicare Part B premiums and long-term care insurance premiums.⁸

The HSA gives you an added benefit over the traditional IRA. With the HSA, you get a deduction when you contribute (benefit number one). Then, when you use the funds for medical expenses, the funds come out tax-free (benefit number two).⁹

Don't forget the added benefit of the funds growing tax-free over years of investing. The tax-free growth also happens in the traditional IRA, but the HSA has no taxes on the back end when you use the accumulation for medical expenses.

Tax deduction going in, tax-free coming out!

Advantage: HSA

Withdraw When You Want

As soon as you turn 70 1/2, the government requires you to start taking some money out of your traditional IRA accounts so the government can start charging you taxes on that income.¹⁰ You may know this obligatory "take it out rule" under its tax name "required minimum distributions" (RMDs).

The HSA has no such requirement. You may take out funds at your leisure with no mandatory withdrawals. And if you are age 65 or over and want to take HSA money willy-nilly for a use other than medical expenses, such as a vacation, you simply pay taxes on that money.¹¹

Advantage: HSA

Penalties

With an IRA, you withdraw funds with no penalty once you reach age 59 1/2. If you take the money out before age 59 1/2, you suffer a 10 percent penalty.¹² There are certain circumstances where you can avoid the penalty when using the funds for medical expenses, but it's unlikely you will completely avoid penalties.

With an HSA, you may withdraw funds tax-free and penalty-free for qualified medical expenses at all times. But if you use HSA monies for nonmedical expenses before age 65, you suffer both the income tax and a 20 percent penalty.¹³ Once you are age 65 or older and you use the monies for nonmedical expenses, you pay the income taxes but zero penalties.¹⁴

Slight Advantage: IRA

Contribution Amounts

You and your spouse can each contribute \$6,000 per year to a traditional IRA.¹⁵ The amount rises to \$7,000 if you are age 50 or older.

For 2019, the maximum contribution to an HSA is \$3,500 for self-only coverage, and \$7,000 for family coverage.¹⁶ Those who are 55 or older on December 31 may contribute an additional \$1,000.

The contribution limits are one area where the traditional IRA provides a significant benefit.

Advantage: IRA

Takeaways

In many ways, the HSA is similar to the traditional IRA. Assuming you meet the requirements for the IRA, you get a tax deduction for your contributions to the account. This also happens with the HSA. Once you have money in the accounts, that money can grow for decades without your paying a dime in taxes.

If you take money out of either the IRA or the HSA prematurely or for unauthorized purposes, you will pay penalties.

But several features of the HSA make this choice rise above the traditional IRA.

With the HSA, you can use the funds at any time for qualified medical expenses, with zero taxes and zero penalties. Once you hit age 65, you may use the funds tax-free for health insurance premiums, including Medicare. These expenses are inevitable, so why not pay them with tax-free cash?

Finally, HSAs have no required minimum distributions. When you are age 65 or older, you can

- take HSA money out tax-free when you use it for medical expenses, or
- use the money for vacations and pay taxes.

¹ IRC Section 223(c)(1).

² Rev. Proc. 2018-30.

³ Ibid.

⁴ IRC Section 219(g); IR 2018-211.

⁵ IRC Section 223(a).

⁶ IRC Section 408(d)(1).

⁷ IRC Section 223(f)(1).

⁸ IRC Section 223(d)(2)(C)(iv).

⁹ In this article, tax-free means free of federal income taxes. Most states follow the federal rules but there are exceptions such as California, New Jersey, and Alabama.

¹⁰ Reg. Section 1.401(a)(9)-1.

¹¹ IRC Section 223(f)(4)(C).

¹² IRC Section 72(t).

¹³ IRC Section 223(f)(4).

¹⁴ Ibid.

¹⁵ IRC Section 219(b)(5)(A); Notice 2018-83.

¹⁶ Rev. Proc. 2018-30.

Five Popular Tax Reform Articles

IRS FAQs on Section 199A: Nasty? Helpful? Wrong?

On April 11, likely after you filed your tax return, the IRS updated its Section 199A frequently asked questions (FAQs) by increasing the number of questions and answers from 12 to 33. We noted three of the FAQs that will cause problems for many taxpayers. In fact, there will be taxpayers who will need to file amended tax returns because of the FAQs.

Q&A: Simple Recap of TCJA Articles

In this article, you see three easy ways to find the Tax Cuts and Jobs Act (TCJA) articles that we have written: (1) use the resource guide to find the articles by topic with short summaries of the prior and new laws; (2) use the Browse by Topic function; or (3) use the search engine.

Employee Recreation and Parties Survive TCJA Tax Reform

When you know the rules, you can party with your employees and deduct 100 percent of the cost. Interestingly, if you feed your employees during a training program, your deduction is only 50 percent. Make sure you know the rules that give you the 100 percent deduction for employee entertainment.

IRS Issues Final Section 199A Regulations and Defines QBI

Your ownership of a pass-through trade or business can generate a tax deduction of up to 20 percent of your qualified business income (QBI). The C corporation does not generate this deduction, but the proprietorship, partnership, S corporation, and certain trusts, estates, and rental properties do. In this article, you learn how to find your QBI.

Seven Answers to Your Section 199A Questions

The Tax Cuts and Jobs Act tax reform added new tax code Section 199A that gives owners of pass-through businesses a possible 20 percent tax deduction on business income. Inside the rules for qualification, you find some complications that give rise to many questions. In this article, we answer seven of those questions.



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