Every year clients ask me what medical expenses are deductible and how they can claim such expenses on their returns. Unfortunately, as with many tax issues, there are many matters to consider when claiming medical expenses and often the final amount that can be claimed is very disappointing, especially when considering the record keeping involved.

Internal Revenue Code 213 is the section of the tax code where the fun journey of exploring medical costs begins and the usual destination is in the more "user friendly" IRS Publication 502.

Medical Expenses Included

According to IRC 213(d), medical care includes expenses incurred for diagnosis, cure, treatment, and prevention of disease or for purposes affecting the function and structure of the body. These amounts also can include payments for long term care services, health insurance, drugs, and transportation and, in certain cases, lodging.

Of course, a taxpayer must reduce the medical expenses to be claimed by any payments made by an insurance policy, either directly to the medical provider or as a reimbursement to the taxpayer.

When to Deduct Medical Expenses

One of the downsides to taking advantage of claiming medical expenses is the provision relating to when to claim such expenses. Since medical costs often run in the thousands if not tens of thousands of dollars, a very real problem arises when trying to claim expenses. Frequently, I see people who must make payments to their medical provider over a period of time that can sometimes straddle tax years. As you will see later, this provision that dictates costs must be deducted in the tax year paid as opposed to the year of medical services, so this provision can cause a problem for taxpayers.

One potential solution to this problem is paying for the medical services by credit card. Although you still owe the same amount, and in your mind you still owe the medical expenses, the IRS deems the medical bills "paid" at the time of the recording of the transaction on the credit card. Thus, the whole amount can then be claimed during that year, since now you owe the credit company and not the medical provider. Of course, the additional problem is that you now have the medical expenses sitting on a charge card and accruing interest generally at a very high rate. Should you opt for this method one must perform a *careful* analysis to see if the tax savings is worth the added cost of interest.

Filing Status and Whose Expenses to Include

Should a married taxpayer contemplate the Married Filing Separately status, there are some additional items. These concerns include whether you live in a community property state or not. You must also be aware of special rules that apply to expenses being paid from a jointly-owned account.

You may claim expenses you paid for yourself, your spouse (oddly even if you are filing separate), and your dependents.

Included Medical Costs—a Closer Look

Although the expenses covered are far too numerous to name here, I will attempt to provide some examples of items that may be overlooked when calculating your medical expenses.

- Devices such as crutches, wheel chairs, glasses, dentures, etc.
- Bandages
- Braille books and magazines
- Fertility enhancement
- Pregnancy test kits
- Birth control pills
- Guide dogs
- Health insurance premiums including Medicare Parts B & D and certain type of Long Term Care Insurance policies
- Stop smoking programs (except over-the-counter medicines)
- Weight loss programs *if* prescribed by a doctor to treat a specific disease such as obesity, hypertension, etc.
- Transportation expenses to receive medical care

Another item to be deducted, with careful calculations, is permanent capital improvements to a home to aid you or your dependents. However, if such improvements actually increase the value of your home you must first subtract any increase in home value from the costs incurred. Only the amount left, if any, is deductible.

Medical Expenses Not Included

On the contrary side, there are certain medical expenses which can't be included. I only mention these here because I am often asked by taxpayers if they can deduct them.

- Health club dues. Although you can deduct, as mentioned earlier, for weight loss programs prescribed for a diagnosed medical condition, these may not include fees for the health club (*i.e.* if you pay a fee for specific weight loss program at a club, then that is deductible. However, the fees to use the gym are *not* deductible.)
- Funeral costs
- Illegal medical procedures
- Over-the-counter medicines
- Nutritional supplements (unless recommended by a medical practitioner as a treatment for a specific condition)
- Health Savings Accounts (HSA) and Medical Savings Accounts (MSA). In a roundabout way you do receive tax benefits with these plans but they are accounted for as Adjustments to Income on page 1 of the 1040 and are not addressed here. See IRS publication 969 for more details.

- Flexible Savings Accounts (FSA). Keep in mind funds contributed to such accounts are on a pre-tax basis. Thus, you can't "double dip" by then claiming expenses withdrawn from these funds for medical care.
- Health Insurance Premiums funded with pre-tax premiums under IRC 125 (*i.e.*, "cafeteria plans"). Generally speaking, *most* health insurance policies you buy through your employer fall in this category and are *not* deductible at tax filing time since you already received a benefit of funding such policies.
- Health Insurance Premiums for the self-employed. These fall under a similar scenario as HSA and MSA. These are generally reported as an Adjustment to Income on page 1 of the 1040. Please note special rules apply and you can't take an adjustment for premiums for any month in which you were eligible to participate in an employer provided group plan. Please see IRS Publication 535 for more details.

<u>The Bottom Line—the Deduction!</u>

You have now gathered all of your documentation and you have excluded those items that don't qualify, and you are ready for that big moment for the tax deduction on Schedule A!

Here is where I hate to be negative, but I must be a realist and tell you that most of the time after all of this work you still won't qualify for this deduction or if so only a minor amount! Here is the kicker: You must first complete page 1 of the 1040 and compute your Adjusted Gross Income (AGI) and take that amount and multiply it by 7.5%. You take this amount and subtract it from your medical expenses and only what is left is what is deductible.

For example let's say you paid out $5,000 in qualified medical expenses. However, your AGI is $100,000. You must take 7.5% ($7,500) and subtract this first. As you can see you are shy by $2,500. Thus, no deduction is allowed! Yes, I know this hurts. I see this every year and time after time this is often the case.

Here is another example. Let's say you still have $5,000 in qualified medical expenses. Except now your income is $50,000. 7.5% of $50,000 is $, 3,750. Thus, in this case you can deduct $1,250 ($5,000-$3,750)! Congratulations!

Well, maybe we shouldn't celebrate too much yet. Here is the next test. You must have enough other itemizations (*i.e.*, home mortgage interest, real estate taxes, charitable contributions, etc.) to beat the standard deduction. Therefore, you may technically have enough medical expenses, but if you don't have enough "itemizations" to complete Schedule A to beat the standard deduction you are still out of luck!

Unfortunately, after nearly 20 years of preparing returns what I have found is that most people who have high enough medical expenses to qualify are elderly. Generally, elderly people who own a home have had it paid in full for years and the largest item I usually find in itemized deductions is the home mortgage interest. This problem is compounded even more because once you are 65 you are entitled to an extra standard deduction of $1,400. Therefore, it has been my experience that is difficult to claim medical expenses. This problem is magnified further by the fact that to help pay for the Affordable Health Care Act (*i.e.* the new health insurance law) you will have to calculate medical expenses against 10% of your AGI rather than 7.5% starting in year 2013 (2016 for those over 65)!

However, even if you don't qualify for the schedule A deduction some states have different thresholds, and although you may not have enough to "itemize" on Schedule A of the federal form you may find you can use some of these expenses on your state income tax return, providing you live in a state with an income tax that allows such a deduction.

This article is not meant to be an extensive explanation on IRC 213, and has been made to be as informative as possible without diving into every specific situation. Thus, considering the "gotcha's" in this provision, I highly encourage you to do further research and/or seek professional guidance before tackling this issue yourself.