Are CCRC Fees Qualified Medical Expenses?

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A portion of CCRC fees may be considered a qualified medical expense for residents to include as a deduction on their individual income tax returns. The CCRC usually provides this information to the residents in January of each year, relating to the previous tax year. In fact, residents and their tax advisors would probably be unable to determine the medical portion of entrance fees and monthly fees without data from the CCRC, so the CCRC has a responsibility to provide such data. The actual use of the data in preparation of the tax return is the responsibility of the resident and his or her tax advisor.

Although acknowledged as deductible since 1966, the IRS has never issued definitive guidelines for calculating the portion of CCRC fees that qualify as a medical expense. Medical expenses and medical insurance costs are deductible expenses. All monthly fees, including room and board charges, are deductible for residents in nursing care, as long as a principle reason for residence is the availability of medical care. Medical care does not need to be *the* principle reason, only a principle reason.

Recent legislation relating to long-term care insurance sets forth a guideline that care for individuals with two or more ADL limitations qualifies as a medical expense. Therefore, to the extent that residents in assisted living exceed that level of disability, monthly fees in assisted living would be a qualified medical expense.

A portion of independent living (ILU) monthly fees and a portion of the entrance fee may also qualify as a medical expense. The IRS allows deductibility of the medical expense in the year a fee is paid, even though the medical services will be performed in the future, or may not be performed at all.

So how should a CCRC determine the medical expense portion of entrance fees and ILU monthly fees? Depending on the type of contract, the medical expense portion may be little or nothing at all, or it may be a substantial amount. Basically, any discounted assisted living and nursing care that may be delivered in the future is prefunded through the entrance fee and/or monthly fees in ILU. Discounted care means that the fees paid at the time of service are less than the costs to provide the service. A contract that does not provide any discounted health care days does not have a medical expense component in the entrance fee or ILU monthly fee.

CCRCs that calculate the medical expense component for their residents use a wide variety of methodologies, which have been accepted by the IRS. The most common approach is the percentage method, where the percentage of medical expenses to total expenses is used as the percentage of entrance fees and ILU monthly fees that could be deductible. If health care is provided for private pay residents, this approach seems invalid, as the medical care percentage would be affected by the size of the care center. One improvement would be to adjust medical expenses and non-medical expenses to a per person cost before calculating the percentage. However, an IRS agent recently opined verbally to an AAHSA representative that the percentage method was not acceptable and that a per capita method is preferred. The percentage method produces medical expenses that vary by the size of independent living unit, so residents in larger units have a greater deduction than residents in smaller units. However, the expected cost of medical care is not related to the size of the independent living unit.

The actuarial approach to calculating the medical expense portion results in a per capita amount rather than a percentage. If a contract provides discounted health care days, the present value of the discount is calculated, which requires an estimate of the timing and duration of health care utilization. The present value is the amount of medical expense that is prefunded through entrance fees and monthly fees in the ILU. If the entire amount is allocated to entrance fees, the present value is the per capita amount of medical expense. If a portion is desired to be allocated to monthly fees, a factor that considers the amount of time in ILU and the time value of money could be applied to determine the split.

CCRCs that employ the actuarial approach use a variety of splits between entrance fee and monthly fee. Generally, the monthly fee portion that has been reported to residents in the past is inflated, and the remaining amount is allocated to entrance fee. From an actuarial perspective, the split is somewhat arbitrary. In fact, each resident at a particular CCRC could use a different allocation, as long as the total medical expense over the expected lifetime matched the present value amount. From an actuarial perspective, the present value of discounted health care varies by age and gender. However for simplicity, most CCRCs base the calculation on a blend of ages and genders that reflects their population.

Many CCRCs are currently considering whether they should change from a percentage methodology to a per capita methodology. The IRS has not issued any written guidelines, and has not indicated that any are under development. And, it is difficult to change the methodology, because residents are very sensitive to this issue and will object if the change results in lower medical expenses. Finally, the competitive factor must be considered. If the CCRC down the street informs residents that their medical expense for the same type of contract is substantially higher than your calculation, prospective residents may choose the other CCRC to get the larger deduction. However, the per capita approach is more supportable to the IRS. Each CCRC will have to evaluate its own situation and determine the best course of action for the future.

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