Income Taxes and Special Needs

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As April 15 looms, people with special needs – and their families, caretakers and trustees – think about the same thing that preoccupies every other American: income taxes. But are there special rules, benefits or practices that are particularly focused on people with special needs? Of course there are.

We wrote about tax tips for parents with a child with special needs back in April of 2014, and the information we shared then is still mostly applicable – though with updated figures for this year's tax filings. In March of 2014, we wrote about tax returns filed by the trustee of a special needs trust, and that information is also still accurate (but with updated figures). You should read those articles! Today, we will update the information in our earlier articles, and add the few new things that have developed since those articles.

Updated figures

First, a look at current (for 2015 tax returns) figures. Two years ago we reported that you may be able to claim your "child" as a dependent, depending on the child's age, living situation, income, and disability, and that doing so would give you an additional personal exemption. For returns filed this year, the value of that personal exemption has increased to $4,000 of reduction in your taxable income; the figure is scheduled to go up next year by another $50. Note that "child" actually includes brothers, sisters, nieces or nephews. For details, you can look at IRS Publication 501.

Our earlier articles also pointed out that, beginning in 2014, it was important to make sure that your child with a disability was covered by appropriate medical insurance. If you list the child as a dependent on your income tax return, lack of insurance coverage for the child could result in a tax penalty to you. The size of that penalty will vary depending on your family size and income, but it could be from a few hundred dollars to a couple thousand

dollars – and the severity of the penalty is slated to increase again for 2016. For 2015, the maximum penalty for an individual is 2 percent of income (or $325, if greater).

Claiming the tax credit for the elderly and disabled

Are you or your spouse over age 65? If so, you might be able to claim an additional tax credit because of your age. That same credit is available to people under 65, if they are receiving taxable disability income and they are permanently and totally disabled. And there is an even bigger credit if the disabled person is under 18. But it's complicated, and it is also limited based on your income. You can check out IRS Publication 524 for the details.

Deductible disability-related expenses

When you are preparing your income tax return, you have the option of itemizing your deductible expenses. Of course, in order to get any benefit from itemization, your medical expense deductions will now need to exceed 10% of your adjusted gross income – but a number of possible medical expense deductions are particularly relevant for people with disabilities:

***Home modifications**. Did you incur costs to modify your home for accessibility? Those expenses might be deductible as medical expenses. This is not available for purely aesthetic improvements, and the deduction can only be claimed to the extent that the work does not increase the value of the home. Still, this can provide a significant tax savings in some cases.*

***Conference and seminar expenses**. If you attend conferences and seminars – even out-of-town – the costs may be deductible as a medical expense if they were essential to your dependent's medical care. Get a letter from your child's physician recommending that you attend, and focusing on the medical care needs. You still won't be able to deduct meals and lodging, though you may be able to deduct travel expenses.*

***Special school expenses**. Generally, educational costs do not qualify for the medical care deduction – but in some circumstances school expenses do qualify. The primary distinction: if the primary reason for attending the school is to alleviate the child's disability through the school's resources and training. If the standard is met, even that portion of the tuition that covers room and board may be deductible. Talk with your tax preparer about this type of deduction.*

***Child and dependent care expenses**. If you pay someone else – generally, not a family member – to care for a dependent child or spouse so that you can work, you might be eligible for a credit for some of those expenses. The rules are a little bit complicated, but the IRS spells them out in its Publication 503, which walks through the process step-by-*

step. In short, the credit can be claimed if the person needing care qualifies as a dependent, if you arrange the care so that you can work and earn income, and the payments are not to certain family members.

Special needs trusts

If a trust is in place for your family member with a disability, then the tax picture can be somewhat more complicated. The trust might need to file a separate income tax return, but in some circumstances the trust's income is reported on the beneficiary's personal income tax return. Talk with your professional tax preparer about which approach is appropriate in your circumstance. Read the 2014 article on this topic.

Regardless of which kind of trust is involved, the person with disabilities might have "income" for tax reporting purposes – without ever having received any direct distributions from the trust. If tax is due, the trust may be able to pay the tax. The fact that income is reported to the beneficiary, though, might well change whether you are able to list an otherwise dependent child on your income tax return, since you must have provided more than half of the child's support.

Occasionally a choice can arise: should the person with whom the trust beneficiary lives claim the trust beneficiary as a dependent, or does it make more sense for the beneficiary to use his or her own personal exemption to reduce the taxes the beneficiary pays? In some high-income trust situations, it can actually save money for the individual to take the exemption and not be named as a dependent, even though that might increase the income taxes for the parent or other caretaker.

If the special needs trust does file a separate tax return, make sure that the tax preparer knows about the "Qualified Disability Trust" option. It might save significant tax liability if the trust can elect to be treated as a disability trust. The eligibility requirements are fairly easy to meet, and the effect is to reduce the trust's taxable income by about $4,000. Trusts usually have only a $100 exemption, but this Qualified Disability Trust status gives the trust the equivalent of an individual's $4,000 personal exemption.

ABLE Act accounts

Since our last tax writing in 2014, the federal government has created a new category of tax-favored accounts specifically for people with disabilities. The Achieving a Better Life Experience (ABLE) Act of 2015 authorizes states to create special savings accounts for people with disabilities – akin to, but different from, 529 college savings plans available for parents and grandparents to save money for education costs. Account earnings will be tax exempt, and distributions will also be tax exempt if made for "qualified disability expenses." However, the accounts are limited in amount, and must repay the State for medical

assistance paid on the beneficiary's behalf once the beneficiary dies. None of this impacts any 2015 income tax return, since no accounts have been established yet.

Congress recently amended the ABLE Act so that an account can be set up in any state without regard to the disabled individual's state of residency. That means that accounts will be available to everyone as soon as any one state has a program actually in place and open for business.

Although one stated reason for the development of ABLE Act accounts was to make them more tax-efficient, the reality is that few tax issues will be addressed by the new law. Contributions by one person into an account for a family member or other beneficiary are not deductible from the income of the donor, and do not create income to the beneficiary. The largest tax effect of ABLE Act accounts will be with respect to the earnings on such accounts once opened. Stay tuned for upcoming articles on the development of ABLE Act accounts and strategies for their use.

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