Spring 2015

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**Recommended Citation**

Brinker, Thomas, "Capital Improvements as a Medical Expense" (2015). *Faculty Publications*. Paper 373.

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Capital Improvements as a Medical Expense

A missed opportunity for families with special needs children?

By Thomas M. Brinker, Jr., JD, LL.M., ChFC®, CPA/PFS, CGMA, CFE, AEP

Over the last few decades, the number of children diagnosed with autism, Asperger's syndrome and other intellectual disorders has skyrocketed from 1 in 10,000 to 1 in 68, according to the Centers for Disease Control (March 28, 2014). In addition to the psychological and financial implications of having a child diagnosed with an autism spectrum disorder, parents of special needs children are often unaware of the substantial tax benefits available to them and may forego many potential tax deductions and credits in determining their tax liability. Medical care expenditures for a special needs child alone can prove astronomical. As a result, advisors need to become familiar with some unusual Internal Revenue Code provisions when assisting their clients in the planning process. An overview of the medical expense deduction is provided here, with discussion of two very common medical expenditures incurred by our families: special schools and capital improvements.

Overview of the Medical Expense Deduction

Only individuals itemizing their deductions on their federal individual income tax returns can claim a medical expense deduction, according to IRC Section 213(a). Unreimbursed medical expenses are deductible only to the extent they exceed 10 percent of a taxpayer's adjusted gross income (AGI). This 10-percent AGI threshold for the medical expense deduction represents an increase from the long-standing 7.5-percent AGI threshold. (The threshold remains at 7.5 percent of AGI for individuals age 65 and older for tax years through 2016 under the Patient Protection Act, as amended by the Health Care and Education Reconciliation Act of 2010.) Alternatively, parents who are eligible to participate in tax-advantaged plans through work for funding medical expenses, such as flexible spending accounts or health savings accounts, can set aside limited amounts of money to finance medical care expenses on a pre-tax basis while bypassing the AGI limitation. Flexible spending account pre-tax contributions were limited to $2,500 in 2014 and have only slightly increased to $2,550 for 2015.

Special School Instruction

In general, a child's educational costs are not considered medical care and are, therefore, not deductible as a medical expense. However, according to Reg.
Sec. 1.213-1(e)(1)(v), the unreimbursed cost of attending a “special school” for an individual with a physical or intellectual disability is deductible as a medical expense, if the principal reason for sending the individual to the school is to alleviate the disability through the school’s resources. This deduction may also include amounts paid for lodging, meals, transportation and the cost of ordinary education incidental to the special services provided by the school. Also, any costs incurred for the supervision, care, treatment and training of an individual with a physical or intellectual disability are deductible, if provided by the institution.

Furthermore, qualifying capital expenditures, medical conferences and seminars, prescribed vitamin therapy, therapeutic assistance, various therapies and special diets can add thousands of dollars to the medical expense deduction annually.

THE MISSED OPPORTUNITY:
CAPITAL EXPENDITURES AS A MEDICAL EXPENSE

Under most circumstances, capital expenditures are not permitted as a medical expense deduction. However, a medical expense deduction is available when the capital expenditure is made primarily for the medical care of the taxpayer, the taxpayer’s spouse and/or the taxpayer’s dependents. To secure a current medical expense deduction for a capital expenditure, the cost must be reasonable in amount and incurred out of medical necessity for primary use by the individual requiring medical care (Reg. Sec. 1.213-1(e)(1)(iii)).

Qualifying capital expenditures for medical expense deductions fall into two categories: (1) expenditures improving the taxpayer’s residence while also providing medical care (e.g., a central air-conditioning system for an individual suffering from a chronic respiratory illness), and (2) expenditures removing structural barriers in the home of an individual with physical limitations (e.g., construction costs incurred for an entrance ramp, widening doorways and halls, customizing bathing facilities, lowering kitchen cabinets and adding railings).

Capital expenditures in the first category are deductible only to the extent that the cost exceeds the increase in the property’s fair market value as a result of the capital expenditure. However, expenditures incurred in the second category are fully deductible under the presumption that there is no increase in the property’s value as a result of removing a physical barrier.

The following example illustrates expenditures in both categories:

This past year, Theresa was injured in a severe automobile accident. Theresa sustained a disabling leg injury, which requires her to spend most of her time in a wheelchair. Her physician recommends that she install an elevator in her home to alleviate the pressure on her knees from walking up and down stairs. During the year, Theresa made the following expenditures: wheelchair, $2,500; elevator, $17,000; operational and maintenance costs incurred with the elevator, $2,800; and entrance ramp and door modifications, $7,500. According to appraisers, the home increased in value as a result of the elevator by $5,000. As a result, Theresa has a $24,800 medical expense deduction before considering AGI limitations for 2014.

Under either category, costs incurred to operate or maintain the capital expenditure (such as increased utility and maintenance costs to operate the elevator) are deductible currently as medical expenses as long as the medical reason for the expenditures continues to exist (Rev. Rul. 87-106, 1987-2 C.B.67).

CONCLUSION

Although many of our families are aware of the medical expense deduction for special schools and education, they often overlook the deduction for a capital expenditure for medical care. As illustrated, this deduction alone can result in saving thousands of tax dollars.