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Federal Tax Policy and Family-Provided Care  
for Older Adults

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# Federal Tax Policy and Family-Provided Care for Older Adults

Richard L. Kaplan

## Abstract

An issue of enormous and increasing significance to the vast majority of older Americans, and their families, is who will care for them as they age and require assistance in their daily lives. Such assistance is usually denominated “long-term care,” because it is a chronic phenomenon that is not limited to some specific medical incident. Such care can be provided in a variety of settings, depending upon the intensity of the older person’s needs and the medical nature of those needs, but 80% of long-term care is provided by family members and close friends on an informal and typically unpaid basis. This phenomenon reflects a wide range of cultural norms in this country, as well as certain economic realities. As more Americans attain ages at which some assistance with daily life activities is typical, the federal tax treatment of family-provided elder care will become increasingly important.

This Article considers how the provision of informal care for older family members is taxed presently and how such treatment should be changed in light of changing family dynamics. It begins with a brief description of what informal elder care consists of and the impact of such care responsibilities on the family members who provide that care. The Article then considers how courts have assessed informal caregiving in the context of gratuitous transfers by the recipients of such care. It then examines the tax treatment of informal caregiving as it relates to the personal exemption and the deduction of medical expenses. The Article next analyzes a number of recent legislative proposals that would provide tax credits for family caregivers. The Article concludes with some policy responses to this growing societal concern.



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# **FEDERAL TAX POLICY AND FAMILY-PROVIDED CARE FOR OLDER ADULTS**

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*Will you still need me, will you still feed me, when I'm sixty-four.*<sup>1</sup>

*Honor thy father and thy mother, that thy days may be long upon the land which the Lord thy God giveth thee.*<sup>2</sup>

*There are only four kinds of people in this world: those who have been caregivers, those who currently are caregivers, those who will be caregivers, and those who will need caregivers.*<sup>3</sup>

## I. INTRODUCTION

An issue of enormous and increasing significance to the vast majority of older Americans, and their families, is who will care for them as they age and require assistance in their daily lives. Such assistance is usually denominated as “long-term care” because it is a chronic phenomenon that is not limited to some specific medical incident.<sup>4</sup> Such care can be provided in a variety of settings, depending upon the intensity of the older person’s needs and the

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<sup>1</sup> THE BEATLES, *When I'm Sixty-Four*, on SGT. PEPPER'S LONELY HEARTS CLUB BAND (Capitol Records 1990) (1967). Upon reading a draft of this article, my fifty-six-year-old wife recoiled at the notion of dependency upon reaching age sixty-four. With no special insight into the Beatles' thinking, I would note the substantial improvements in elders' health that have taken place during the nearly four decades since this song was released. Furthermore, to the song's target audience of teenagers, persons who are sixty-four or eighty-four years old are comparably ancient.

<sup>2</sup> *Exodus* 20:12; see also *Deuteronomy* 5:16.

<sup>3</sup> ROSALYNN CARTER WITH SUSAN K. GOLANT, *HELPING YOURSELF HELP OTHERS: A BOOK FOR CAREGIVERS* 3 (1994).

<sup>4</sup> See ROSALIE A. KANE ET AL., *THE HEART OF LONG-TERM CARE* 3–4 (1998); Christine Bishop, *Long-Term-Care Needs of Elders and Persons with Disability*, in *LONG-TERM CARE AND MEDICARE POLICY* 21, 21–22 (David Blumenthal et al. eds., 2003).

medical nature of those needs. The most common image of a long-term care setting — a nursing home — is actually the most intensive environment,<sup>5</sup> especially when the level of care that is being provided there is classified as “skilled care.”<sup>6</sup> Assisted living facilities, continuing care retirement communities, board and care homes, and adult day care centers also provide long-term care but in less intensively medical settings.<sup>7</sup> In some circumstances, older people receive long-term care in their own homes from various home health care agencies and other vendors that tailor the services that they provide to what the specific client needs.<sup>8</sup>

Most long-term care, however, is provided by family members and close friends on an informal and typically unpaid basis.<sup>9</sup> This phenomenon reflects a wide range of cultural norms in this country, as well as certain economic realities.<sup>10</sup> And as more Americans attain ages at which some assistance with daily life activities is typical,<sup>11</sup> the federal tax treatment of family-provided elder care will become increasingly important.

This Article considers how the provision of informal care for older family members is taxed presently and how such treatment should be changed in light of changing family dynamics. It begins with

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<sup>5</sup> See Richard L. Kaplan, *Cracking the Conundrum: Toward a Rational Financing of Long-Term Care*, 2004 U. ILL. L. REV. 47, 56–57.

<sup>6</sup> See 42 C.F.R. § 409.33(a)–(c) (2005) (providing examples of “skilled nursing care” for Medicare purposes).

<sup>7</sup> See KANE ET AL., *supra* note 4, at 159–88; Kaplan, *supra* note 5, at 52–56. See generally LAWRENCE A. FROLIK, RESIDENCE OPTIONS FOR OLDER OR DISABLED CLIENTS (3d ed. 2001); UNITED SENIORS HEALTH COUNCIL, LONG-TERM CARE PLANNING — A DOLLAR AND SENSE GUIDE (rev. ed. 2001).

<sup>8</sup> See FROLIK, *supra* note 7, ¶ 11.04[1][d]; KANE ET AL., *supra* note 4, at 119–57; Kaplan, *supra* note 5, at 50–52.

<sup>9</sup> See KANE ET AL., *supra* note 4, at 14–15; ALICE M. RIVLIN & JOSHUA M. WIENER, CARING FOR THE DISABLED ELDERLY 5 (1988) (“[T]he predominant provider of long-term care in the United States is the family.”).

<sup>10</sup> See Sue Shellenbarger, *Caregivers Begin To Raise Questions About Pay for Efforts*, WALL ST. J., Jan. 24, 2001, at B1 (“The notion that family members should care for each other out of love and duty is rooted deep in our definition of decency.”). See generally UNITED HOSPITAL FUND OF NEW YORK, ALWAYS ON CALL: WHEN ILLNESS TURNS FAMILIES INTO CAREGIVERS (Carol Levine ed., 2000); ETHNIC ELDERLY AND LONG-TERM CARE (Charles M. Barresi & Donald E. Stull eds., 1993).

<sup>11</sup> See RIVLIN & WIENER, *supra* note 9, at 5; LAURA L. SUMMER & EMILY S. IHARA, STATE-FUNDED HOME AND COMMUNITY-BASED SERVICE PROGRAMS FOR OLDER PEOPLE 1 (2004), available at [http://assets.aarp.org/rgcenter/post-import/2004\\_11\\_hcbs.pdf](http://assets.aarp.org/rgcenter/post-import/2004_11_hcbs.pdf) (“The aging of society will have a significant impact on the demand for long-term care.”).

a brief description of what informal elder care consists of and the impact of such care responsibilities on the family members who provide that care. The Article then considers how courts have assessed informal caregiving in the context of gratuitous transfers by the recipients of such care. It then examines the tax treatment of informal caregiving as it relates to the personal exemption and the deduction of medical expenses. The Article next analyzes a number of recent legislative proposals that would provide tax credits for family caregivers. The Article concludes with some policy responses to this growing societal concern.

## II. THE NATURE OF FAMILY-PROVIDED ELDER CARE

Informal elder care varies considerably in terms of what it actually entails. Sometimes, it consists of assisting with meals, monitoring medications, and maintaining personal hygiene.<sup>12</sup> For other people, elder care may involve help with bathroom functions, dressing, and basic mobility.<sup>13</sup> In still other situations, elder care comprises tasks that relate more directly to an elder's social well-being than to that person's physical condition, such as transportation to medical appointments, shopping excursions, religious services, and cultural events.<sup>14</sup> But the main point is that informal elder care typically requires its provider to have more patience than medical knowledge, what might be described colloquially as "high touch" rather than "high tech."<sup>15</sup>

Regardless of its specific components, informal elder care is most often provided in one of the following settings:

- The elder's home by that person's spouse, or an adult son, daughter, or sibling who moves into the elder's home.
- The elder's home by unpaid "helpers" from various religious, civic, or community groups, with this care typically being supplemented by care from the elder's

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<sup>12</sup> FROLIK, *supra* note 7, ¶ 11.04, at 11-19; KANE ET AL., *supra* note 4, at 4.

<sup>13</sup> See *supra* note 12.

<sup>14</sup> *Id.*

<sup>15</sup> See KANE ET AL., *supra* note 4, at 32 ("[L]ong-term care uses relatively little expensive or complex technology."); Bishop, *supra* note 4, at 36-37 ("The technological changes that are affecting so many aspects of . . . modern life are unlikely to have much impact on a service that consists of hours of hands-on one-to-one care.").

relatives after normal working hours.

- Some relative's home following a move by the elder to that home.

Whatever the specific setting, such care is characterized by the absence of formalized arrangements or regular transfers of financial resources.

The very nature of informal elder care makes precise calibration of its dimensions difficult, but some careful studies provide informative estimates. One study of "caregivers to the elderly" found that the number of households with such responsibilities grew from 7 million in 1987 to more than 21 million in 1997, an increase of 300% in just ten years.<sup>16</sup> Moreover, this study projected that this number would rise to 39 million by the year 2007.<sup>17</sup> Indeed, a report published by the National Alliance for Caregiving stated that informal care constitutes almost 80% of all long-term care that is provided to older Americans.<sup>18</sup> And a report that was issued by the AARP Public Policy Institute in April 2005 noted that informal care for persons who were at least sixty-five years old amounts to 5.8 billion hours on an annual basis.<sup>19</sup> Thus, this report concluded, "the total value of unpaid care is roughly comparable to the \$182 billion estimate for paid long-term care and independent living services."<sup>20</sup>

The economic impact on the individual caregiver is also enormous. The most recent survey<sup>21</sup> of caregivers for older adults<sup>22</sup>

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<sup>16</sup> DONNA L. WAGNER, NAT'L ALLIANCE FOR CAREGIVING, COMPARATIVE ANALYSIS OF CAREGIVER DATA FOR CAREGIVERS TO THE ELDERLY: 1987 AND 1997, at 1 (1997), available at <http://www.caregiving.org/data/analysis.pdf>.

<sup>17</sup> *Id.*

<sup>18</sup> JOHN MIGLIACCIO & NEAL E. CUTLER, NAT'L ALLIANCE FOR CAREGIVING, CARING TODAY, PLANNING FOR TOMORROW 3 (1999), available at <http://www.caregiving.org/data/archives/nacguide.pdf>.

<sup>19</sup> MARC P. FREIMAN, AARP PUB. POLICY INST., A NEW LOOK AT U.S. EXPENDITURES FOR LONG-TERM CARE AND INDEPENDENT LIVING SERVICES, SETTINGS, AND TECHNOLOGIES FOR THE YEAR 2000, at 21 (2005), available at [http://assets.aarp.org/rgcenter/il/2005\\_04\\_ltc\\_costs.pdf](http://assets.aarp.org/rgcenter/il/2005_04_ltc_costs.pdf).

<sup>20</sup> *Id.* Another study estimated the value of informal care at \$196 billion. See Peter S. Arno et al., *The Economic Value of Informal Caregiving*, HEALTH AFF., Mar.-Apr. 1999, at 182, 184.

<sup>21</sup> FAMILY CAREGIVING IN THE U.S.: FINDINGS FROM A NATIONAL SURVEY (1997), available at <http://www.caregiving.org/data/archives/finalreport.pdf>. This survey was sponsored by the National Alliance for Caregiving and the American Association of Retired Persons.

<sup>22</sup> For purposes of this survey, an "older adult" was defined as someone at least fifty years old. *Id.* at 6.

found that nearly 73% of family caregivers are female,<sup>23</sup> one in eight is at least sixty-five years old,<sup>24</sup> and 52% are employed full-time outside the home.<sup>25</sup> By assuming these elder care responsibilities, family caregivers typically lose or give up job opportunities for advancement, especially when those opportunities require extended hours or overnight travel on a regular basis. Moreover, their uncompensated labor is ignored in calculating Social Security credits or entitlement to Medicare benefits. In addition, contributions to self-funded retirement savings plans, such as individual retirement accounts and so-called 401(k) arrangements, may be sharply curtailed or even eliminated, because those contributions can generally be made only from earned income.<sup>26</sup> According to a study that was conducted by MetLife, a major long-term care insurance company, the combination of reduced working hours, foregone promotions, and in some cases the complete cessation of compensated employment produces an average loss of wealth due to family caregiving of more than \$659,000 when measured on a lifetime basis.<sup>27</sup>

The health care impact of family caregiving is also significant. Informal caregivers experience chronic stress, which jeopardizes their immune system and leaves them exposed to health problems of potentially major consequence.<sup>28</sup> Elder care responsibilities, especially for older relatives who suffer from dementia, raise the caregiver's risk of "heart disease, certain cancers, arthritis, diabetes, osteoporosis and other age-related illnesses."<sup>29</sup> As the researchers who conducted a 2003 study of family caregivers stated, "[s]tress of caregivers is psychologically and physically aging them more than

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<sup>23</sup> *Id.* at 10.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* at 11. An additional 12.3% are employed on a part-time basis. *Id.*

<sup>26</sup> I.R.C. § 219(b)(1)(B) (contributions to an individual retirement account may not exceed the taxpayer's "compensation"); *Id.* § 415(c)(1)(B) (similar rule for defined contribution retirement accounts). In some circumstances, a spouse without any earned income may nevertheless fund an individual retirement account, but the amount that can be contributed to this account is limited by the other spouse's "compensation." *Id.* § 219(c)(1)(B). See generally DONALD R. LEVY ET AL., INDIVIDUAL RETIREMENT ACCOUNT ANSWER BOOK 3-2 (4th ed. 1998).

<sup>27</sup> METRO. LIFE INS. CO., THE METLIFE JUGGLING ACT STUDY: BALANCING CAREGIVING WITH WORK AND THE COSTS INVOLVED 6 (1999), available at <http://www.metlife.com/WPSAssets/12949500261100547900V1FJuggling%20Study%20-111004.pdf>.

<sup>28</sup> See Christopher Windham, *Elderly Caregivers Face Stress Toll*, WALL ST. J., July 1, 2003, at D4.

<sup>29</sup> *Id.*

their noncaregiving counterparts.”<sup>30</sup> Previous studies of family caregivers reported an increased risk of dying and more depression as the level of care that they were providing increased.<sup>31</sup> Indeed, a report published by the Urban Institute concluded that “[t]he provision of care appears to be determined primarily by the needs of the parent, while the ease with which adult children can fulfill these needs plays only a secondary role.”<sup>32</sup>

On the other hand, the National Academy on Aging found that “50 percent of elderly people with long-term care needs who lack a family network live in nursing homes, compared to only 7 percent of those who do have family caregivers.”<sup>33</sup> Such results fulfill the desire by most older Americans to live out their days in their own home. Indeed, a survey by the AARP found that fully 85% of respondents expressed this preference.<sup>34</sup>

In any case, the projected increase in the number of older Americans makes consideration of informal caregiving an especially timely subject, because the situation is likely to become more problematic. A report that was issued by the federal government in 2003 described the predicament that the baby boom generation will face with respect to informal elder care as follows:

[L]ower rates of marriage and higher rates of divorce are the distinguishing marital characteristics of this generation, resulting in more baby boomers moving into middle and older ages without a spouse to help with potential care needs.

Elderly baby boomers will have fewer adult children available to provide informal care. This can be attributed to their fertility rate also being lower than that of their parents, and the fact that baby boomers are somewhat more likely than earlier generations to be childless.<sup>35</sup>

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<sup>30</sup> *Id.*

<sup>31</sup> *See id.*

<sup>32</sup> Richard W. Johnson & Anthony T. Lo Sasso, *Parental Care at Midlife: Balancing Work and Family Responsibilities near Retirement*, URB. INST. BRIEF SERIES (Urb. Inst./Retirement Project, Washington, D.C.), Mar. 2000, at 4.

<sup>33</sup> NAT'L ACAD. ON AGING, FACTS ON . . . LONG-TERM CARE (1997).

<sup>34</sup> *See* MIGLIACCIO & CUTLER, *supra* note 18, at 14.

<sup>35</sup> OFFICE OF THE ASSISTANT SEC'Y FOR PLANNING & EVALUATION, U.S. DEP'T OF HEALTH & HUMAN SERVS. ET AL., *THE FUTURE SUPPLY OF LONG-TERM CARE WORKERS IN RELATION TO THE AGING BABY BOOM GENERATION: REPORT TO CONGRESS 7-8* (2003) (footnotes omitted); *see also* Douglas A. Wolf, *The Family as*

Accordingly, this Article now examines the federal tax treatment of informal elder care, beginning with an analysis of gratuitous transfers from the recipients of such care to their caregivers.

### III. GRATUITOUS TRANSFERS TO PROVIDERS OF ELDER CARE

When the recipients of informal elder care convey property to the providers of such care, a critical tax question arises about whether those conveyances represent compensation for services rendered or gifts. The distinction between compensation and gifts, of course, is one of the very first line-drawing controversies that law students confront when they begin to study the law of income taxation.<sup>36</sup> The source of this distinction is the dramatically different treatment that the tax law accords these two types of transfers: gifts are tax-free to the recipient under an explicit exclusion in section 102(a), while compensation is taxable as a specifically included item in section 61(a)(1). In point of fact, this dichotomous treatment is even more significant than this simple statement implies. Gifts are received free of income tax at the federal level and the state level as well,<sup>37</sup> regardless of whether the gift is a lifetime (i.e., *inter vivos*) transfer or a post-death (i.e., testamentary) transfer, such as an inheritance, bequest, or devise.<sup>38</sup> Compensation, on the other hand, is subject to:

- Federal income tax at nominal rates up to 35%,<sup>39</sup> and effective marginal rates that are often even higher due to various income-based phase-outs,<sup>40</sup>
- Social Security taxes of 12.4% on earnings<sup>41</sup> up to an

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*Provider of Long-Term Care*, 11 J. AGING & HEALTH 360, 362 (1999).

<sup>36</sup> See, e.g., JAMES J. FREELAND ET AL., *FUNDAMENTALS OF FEDERAL INCOME TAXATION* 70–82 (13th ed. 2004).

<sup>37</sup> See 2 JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, *STATE TAXATION* ¶ 20.02, at 20-6 (3d ed. 2003) (“The overwhelming majority of . . . states with broad-based income taxes employ federal adjusted gross income as the computational starting point . . .”).

<sup>38</sup> I.R.C. § 102(a).

<sup>39</sup> *Id.* § 1(i)(2).

<sup>40</sup> See, e.g., *id.* § 68(a)(1) (phase-out of itemized deductions); *id.* § 151(d)(3) (phase-out of personal exemptions). See generally Calvin H. Johnson, *Simplification: Replace the Personal Exemptions Phaseout Bubble*, 77 TAX NOTES 1403 (Dec. 22, 1997); Calvin H. Johnson, *Simplification: Replacement of the Section 68 Limitation on Itemized Deductions*, 78 TAX NOTES 89 (Jan. 5, 1998); William D. Popkin, *Phantom Tax Rates*, 78 TAX NOTES 1409 (Mar. 16, 1998).

<sup>41</sup> I.R.C. §§ 3101(a), 3111(a). This tax is collected one-half (i.e., 6.2%) from employees and one-half from employers, but economists generally treat the

annually adjusted amount,<sup>42</sup> which was \$90,000 in 2005,<sup>43</sup>

- Medicare taxes of 2.9% on all earnings,<sup>44</sup> and
- State (and often local) income taxes in most of the sub-federal jurisdictions that impose a tax on “income.”<sup>45</sup>

With so much at stake, it is hardly surprising that taxpayers have long sought to characterize compensation for services rendered as gratuitous transfers instead.

This Part begins by examining some of the key judicial precedents that involve the compensation vs. gift distinction. It then considers this issue in the specific context of transfers to family caregivers. The Part concludes by analyzing the potential of written care agreements to resolve this conundrum in the context of family caregiving.

### *A. Compensation Versus Gifts*

#### 1. Inter Vivos Gifts

As most law school tax casebooks indicate,<sup>46</sup> the leading case on the distinction between compensation and gifts is *Commissioner v. Duberstein*.<sup>47</sup> In that case, Mr. Duberstein worked in the metals

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employers' portion as being paid ultimately by the employees. See C. EUGENE STEUERLE & JON M. BAKIJA, *RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY* 74-75 (1994).

<sup>42</sup> I.R.C. § 3121(a)(1).

<sup>43</sup> I.R.S. Notice 2004-73, 2004-46 I.R.B. 841.

<sup>44</sup> I.R.C. §§ 3101(b), 3111(b). This tax is also collected one-half (i.e., 1.45%) from employees and one-half from employers. See STEUERLE & BAKIJA, *supra* note 41.

<sup>45</sup> See 2 All St. Tax Guide (RIA) ¶ 3112, at 3057 (Dec. 14, 1993) (listing states that use federal income in determining their tax base).

<sup>46</sup> See WILLIAM D. ANDREWS, *BASIC FEDERAL INCOME TAXATION* 170 (5th ed. 1999); J. MARTIN BURKE & MICHAEL K. FRIEL, *TAXATION OF INDIVIDUAL INCOME* 98 (7th ed. 2004); JOSEPH M. DODGE ET AL., *FEDERAL INCOME TAX: DOCTRINE, STRUCTURE, AND POLICY* 169 (3d ed. 2004); FREELAND ET AL., *supra* note 36, at 71; MICHAEL J. GRAETZ & DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION* 127 (5th ed. 2005); ALAN GUNN & LARRY D. WARD, *FEDERAL INCOME TAXATION* 172 (5th ed. 2002); WILLIAM A. KLEIN ET AL., *FEDERAL INCOME TAXATION* 74 (13th ed. 2003); MICHAEL A. LIVINGSTON, *TAXATION: LAW, PLANNING, AND POLICY* 37 (2003); LAURIE L. MALMAN ET AL., *THE INDIVIDUAL TAX BASE* 97 (2002); PAUL R. MCDANIEL ET AL., *FEDERAL INCOME TAXATION* 119 (5th ed. 2004); JOEL S. NEWMAN, *FEDERAL INCOME TAXATION* 79 (3d ed. 2005); RICHARD SCHMALBECK & LAWRENCE ZELENAK, *FEDERAL INCOME TAXATION* 87 (2004); RICHARD A. WESTIN, *BASIC FEDERAL INCOME TAXATION* 164 (2002).

<sup>47</sup> 363 U.S. 278 (1960).

business as president of his own Ohio-based company.<sup>48</sup> His company regularly did business with a New York City enterprise that was named Mohawk Metal Corporation. The president of Mohawk was a Mr. Berman. The two men did business together for many years, and Mr. Duberstein occasionally gave Mr. Berman the names of potential customers for some of Mohawk's products.<sup>49</sup> Mr. Duberstein provided these names because his own company had no interest in meeting these particular customers' requirements.<sup>50</sup> Duberstein, in other words, believed that he was not giving up anything of real value to him.

Nevertheless, Mr. Berman was very grateful for these business leads, and in 1951, Berman sent Duberstein a Cadillac automobile to show his appreciation.<sup>51</sup> Mr. Duberstein never asked for nor expected anything in exchange for the business leads that he provided and informed Mr. Berman accordingly. In fact, Duberstein told Berman that another car, even a Cadillac, was really superfluous and "that Berman owed him nothing."<sup>52</sup> Duberstein did acknowledge, however, that "he did not think Berman would have sent him the Cadillac if he had not furnished him with information about the customers."<sup>53</sup>

Mr. Duberstein eventually accepted the car but did not include its value in his gross income, because he considered the car a gift.<sup>54</sup> By all accounts, Duberstein gave Berman the customer information as an act of pure kindness, neither expecting nor wanting anything in return. Nevertheless, the United States Supreme Court ruled that the value of the car was not a gift but instead was "a recompense for Duberstein's past services, or an inducement for him to be of further service in the future."<sup>55</sup>

The Court's decision was instructive on several levels. First, it suggested that a transfer's status as a gift must be determined not by examining the position of the recipient (here, Duberstein) but rather the position of the transferor, the putative donor.<sup>56</sup> Second, for a transfer to be regarded as a "gift," it must "proceed from a 'detached and disinterested generosity,' . . . 'out of affection, respect, admiration,

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<sup>48</sup> *Id.* at 280.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.*

<sup>52</sup> *Id.*

<sup>53</sup> *Id.* at 281.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 292.

<sup>56</sup> *Id.* at 285–86.

charity or like impulses.”<sup>57</sup> The critical focus, in other words, is the motivation of the person who transferred the asset in question.

At that point, Mr. Duberstein’s claim to “gift” status was largely lost. Even though he had acted with complete charity in giving the business leads to Mr. Berman, the recipient of this information had every business reason to encourage the continuation of those leads. Berman made money from those leads and no doubt thought that some tangible manifestation of his appreciation for this valuable information might translate into more leads in the future, notwithstanding Mr. Duberstein’s protestation that Berman owed him nothing. In other words, the free Cadillac began to look more like a finder’s fee, a referral commission, or a tip — all of which are clearly taxable as compensation under section 61(a)(1).

That Mr. Duberstein was a self-employed entrepreneur and not in Mr. Berman’s employ was inconsequential. Nonemployees can receive compensation for rendering services, however occasional or episodic. Indeed, section 61(a)(1) specifically includes fees and commissions if they represent compensation for services rendered.

To be sure, the case against Mr. Duberstein was made even stronger by certain facts that he was undoubtedly unaware of. It turned out that the legal source of his Cadillac was *not* his friend Berman, but rather Mr. Berman’s company, the Mohawk Metal Corporation. Furthermore, Mohawk deducted the value of the automobile on its corporate income tax return “as a business expense.”<sup>58</sup> Such characterization was probably correct, though the Court did not decide that issue. Mohawk, after all, was the entity that exploited the information that Duberstein had given in the past<sup>59</sup> and that would undoubtedly benefit from future referrals as well. Thus, it made good business sense for Mohawk to retain this source of valuable information by keeping Mr. Duberstein happy. But that very business decision vitiated any claim that the transferor of the automobile proceeded from a “detached and disinterested generosity, . . . out of affection, respect, admiration, charity or like impulses.”<sup>60</sup> To the contrary, the cold-hearted business calculation that justified Mohawk’s tax deduction largely eliminated any claim by Mr. Duberstein that the car was intended as a gift.

We will never know what the result would have been if Mr.

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<sup>57</sup> *Id.* at 285.

<sup>58</sup> *Id.* at 281.

<sup>59</sup> *Id.* at 280.

<sup>60</sup> *Id.* at 285.

Berman had paid for the car personally and had not run this expenditure through his business corporation. The Court's characterization might well have been the same; namely, that the car was taxable as compensation — either for Duberstein's past services or for his anticipated future services. After all, Mr. Duberstein had no way of knowing in advance that Mohawk Metal Corporation was his nominal benefactor or that it had deducted the car as an expense. The *Duberstein* decision, then, stands for the somewhat awkward conclusion that the motivation and the actions of the transferor determine a transfer's characterization as compensation or gift.<sup>61</sup>

Interestingly, the same Court that heard the *Duberstein* case also heard a companion case, *Stanton v. United States*.<sup>62</sup> Mr. Stanton was a full-time employee for ten years of the Trinity Church in New York.<sup>63</sup> In connection with a personal dispute that involved another employee, Mr. Stanton resigned to start a new business venture.<sup>64</sup> The church's operating company awarded Mr. Stanton a \$20,000 payment "in appreciation of [his] services."<sup>65</sup> The Supreme Court did not decide the tax status of this "gratuity" and instead remanded the case for further proceedings.<sup>66</sup> Upon remand, Mr. Stanton won, in part because: (1) he had been compensated in the past for his services, unlike Mr. Duberstein; and (2) he could not be expected to provide similar services in the future, again unlike Mr. Duberstein.<sup>67</sup> The fact that Mr. Stanton's former employer was a charitable organization with no need to deduct this payment may have been helpful as well, but the Supreme Court in *Duberstein* specifically noted that "[t]he taxing statute does not make nondeductibility by the transferor a condition on the 'gift' exclusion."<sup>68</sup> *Stanton* illustrates the characterization difficulty when former employers have both compensatory and donative motives — a situation that is more common than the tax law's compensation-gift dichotomy generally allows.<sup>69</sup>

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<sup>61</sup> See *id.* at 287 ("[I]t is doubtless relevant to the over-all inference that the transferor treats a payment as a business deduction . . .").

<sup>62</sup> *Id.* at 281.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.* at 281–82.

<sup>65</sup> *Id.* at 281.

<sup>66</sup> *Id.* at 293.

<sup>67</sup> *Stanton v. United States*, 186 F. Supp. 393, 396–97 (E.D.N.Y. 1960), *aff'd*, 287 F.2d 876 (2d Cir. 1961).

<sup>68</sup> 363 U.S. at 287.

<sup>69</sup> See I.R.C. § 102(c)(1) (stating that transfers from employers to employees are not excludible as gifts); see also *Goodwin v. United States*, 67 F.3d 149 (8th Cir. 1995)

## 2. Testamentary Transfers

Though the preceding discussion dealt with inter vivos gifts, the same principles apply to testamentary transfers as well. The issue is still whether the putative donor, in this case the decedent, intended to make a gratuitous transfer, or whether the arrangement was essentially compensatory in nature. This question was presented over thirty years ago in *Wolder v. Commissioner*.<sup>70</sup> Mr. Wolder was a lawyer who provided various legal services throughout the lifetime of his client, a Mrs. Boyce, without charging her a fee.<sup>71</sup> Far from having eleemosynary objectives, however, Mr. Wolder simply wrote himself into Mrs. Boyce's will for a specific bequest. This arrangement was memorialized in a written agreement that recited Mr. Wolder's past services for which no charges had been billed and further provided that there would be no bill for "such legal services as she shall in her opinion personally require from time to time."<sup>72</sup> Each side kept its part of the bargain: Mr. Wolder did not bill Mrs. Boyce for the legal services that he rendered, and Mrs. Boyce agreed to a codicil that bequeathed to Mr. Wolder nearly \$16,000 and some specified securities.<sup>73</sup> When Mrs. Boyce passed away, her residuary legatees contested the will, but the probate court found that Mr. Wolder had in fact performed legal services to Mrs. Boyce throughout her lifetime and had not billed her for those services.<sup>74</sup>

Indeed, it was these very facts that enabled the government to characterize this plan as essentially deferred compensation rather than a tax-free bequest. Citing the Supreme Court's decision in *Duberstein*<sup>75</sup> that was analyzed above,<sup>76</sup> the Second Circuit Court of Appeals held that the issue of whether a gift is bona fide is "resolved by an examination of the intent of the parties, the reasons for the transfer, and the parties' performance in accordance with their intentions."<sup>77</sup> The critical test, the court observed, is what is "the

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(holding that a pastor was taxable on cash "gifts" that were made regularly by congregants to supplement his salary).

<sup>70</sup> 493 F.2d 608 (2d Cir. 1974).

<sup>71</sup> *Id.* at 610.

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Commissioner v. Duberstein*, 363 U.S. 278 (1960).

<sup>76</sup> *See supra* Part III.A.1.

<sup>77</sup> 493 F.2d at 612.

dominant reason” for the transfer at issue,<sup>78</sup> bearing in mind that “[t]he congressional purpose is to tax income comprehensively.”<sup>79</sup> It noted further that the transfer in the *Duberstein* case was “made without consideration, with *no legal or moral obligation*, . . . but which was nevertheless held not to be a gift excludable under § 102(a).”<sup>80</sup> Accordingly, the effort by Mr. Wolder to transmogrify his taxable legal fees into a tax-free bequest was rejected.

In this case, the putative donor was Mrs. Boyce, who clearly had no donative purpose in mind and was merely fulfilling her contractual obligation to pay Mr. Wolder via her will. Similarly, Mr. Wolder had no donative expectation but was simply making a business judgment that receiving income free of federal income tax, (and New York state and local income taxes, as well), plus federal payroll taxes (Social Security and Medicare), was worth taking some considerable risks. Those risks included the following:

- Mrs. Boyce might change her will, cutting out Mr. Wolder entirely or perhaps reducing substantially the amount of his likely inheritance.
- The securities specified in Mrs. Boyce’s will for Mr. Wolder might decline in value.<sup>81</sup>
- Mrs. Boyce might outlive Mr. Wolder. In fact, almost two decades elapsed between when the parties signed their agreement and when Mr. Wolder received his bequest.<sup>82</sup>
- Mrs. Boyce’s heirs might successfully challenge the will under the grounds of “undue influence.” Even an unsuccessful challenge — i.e., Mr. Wolder wins his case — could engender negative publicity if Wolder were characterized by some anti-lawyer journalist as an attorney who fleeces his own clients.

Clearly, the decision by Mr. Wolder to seek bequest status was a tough call that was fraught with significant downside potential, but that is what it was: a business decision, and not a donative

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<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> *Id.* (emphasis added).

<sup>81</sup> In point of fact, the specified securities were the subject of a corporate merger, but Mrs. Boyce bequeathed to Mr. Wolder shares in the successor corporation. *Id.* at 610.

<sup>82</sup> *See id.* (agreement made in 1947; property received in 1966).

arrangement. Be that as it may, the bottom line for testamentary transfers is the same as for lifetime gifts — namely, the motivation of the transferor determines whether the transfer will be characterized as taxable compensation or as a tax-free gratuity.<sup>83</sup>

### B. *The Dieter Controversy*

Against the backdrop of these judicial efforts to monitor the line of demarcation between compensation and donative transfers now comes *United States v. Dieter*,<sup>84</sup> a case that involved a family caregiver for an older relative. The facts are unfortunately somewhat convoluted, but the issue that they present has enormous implications for simpler arrangements wherein a family member who cares for an aging relative receives lifetime gifts or testamentary transfers in tacit recognition of the care that the family member provided.

Mary Dieter was married to Michael McNeal, the son of Alberta McNeal, an older woman who was afflicted with Parkinson's disease and other ailments that made living on her own problematic.<sup>85</sup> For some time, Alberta had been cared for by her daughter, Maureen, who was also Michael's sister. Maureen was a single parent who had a full-time job in the compensated workforce. When Maureen could no longer provide elder care for her mother Alberta, the family discussed the possibility of placing Alberta in a senior living facility. Alberta, however, wanted to remain in her own home, so Michael and Mary (and Mary's two sons) moved from Iowa to Minneapolis to care for Alberta in her large home there.<sup>86</sup>

For more than six years, Mary kept house for Alberta, did the cooking and laundry for her, and drove her to medical appointments as well as social events. Mary also bathed Alberta and handled her financial affairs. In exchange, Mary and her family lived with Alberta without incurring any expenses for housing or groceries.<sup>87</sup>

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<sup>83</sup> The *Wolder* court cited four cases “holding testamentary transfers to be taxable compensation for services as opposed to tax-free bequests.” *Id.* at 612. But in each of those cases, the taxpayer had *not* been named in the decedent's will and was enforcing a claim for compensation against the decedent's estate. *See* Cotnam v. Commissioner, 263 F.2d 119 (5th Cir. 1959) (services as an “attendant or friend”); Cohen v. United States, 241 F. Supp. 740 (E.D. Mich. 1965) (operated decedent's corporation); Mariani v. Commissioner, 54 T.C. 135 (1970) (ranch superintendent); Davies v. Commissioner, 23 T.C. 524 (1954) (nurse, secretary, and bookkeeper).

<sup>84</sup> 2003-1 U.S.T.C. ¶ 50,439 (D. Minn. 2003).

<sup>85</sup> *Id.* ¶ 50,439, at 88,258.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* ¶ 50,439, at 88,259.

Four years into this six-year period, Michael sold Alberta's large house and moved Alberta and his family into a smaller house that did not have the stairways that Alberta was finding increasingly difficult to navigate. Michael was authorized to transact the sale of Alberta's house pursuant to his powers under a revocable living trust that Alberta had created. The responsibility for finding the new home, however, fell entirely to Mary.<sup>88</sup>

Two years later, Alberta's condition had deteriorated further, and Alberta was moved into a nursing home. At that time, Michael's sister Maureen re-entered the picture, because Michael and Mary continued to live in Alberta's home even though she was no longer there. After some contentious litigation, including a request for removal of Michael as trustee, a special conservator was appointed, and the matter was resolved by a Release and Settlement Agreement (Release). This Release divided Alberta's assets (though Alberta was still alive) and gave title to the house to Mary's son, Corey, in discharge of any claims that Mary might have for services that she rendered in caring for Alberta before Alberta moved into the nursing home.<sup>89</sup>

Apart from some issues involving why Corey was given title to the house, which related to an effort by Michael and Mary to avoid possible tax liens,<sup>90</sup> the critical question of this case was whether Mary was taxable on the value of Alberta's new home. The district court held that she was, noting that "it appears to be well-settled that compensation received for providing attendant-care services to a family member is properly included in gross income."<sup>91</sup> The only issue, the court determined, was *whether* the home was transferred as such compensation.<sup>92</sup>

Unlike the situation in the *Wolder* case,<sup>93</sup> there was no written

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<sup>88</sup> *Id.*

<sup>89</sup> *Id.* ¶ 50,439, at 88,259–60.

<sup>90</sup> *Id.* ¶ 50,439, at 88,261.

<sup>91</sup> *Id.* ¶ 50,439, at 88,264. In support of this proposition, the court cited three cases involving third-party payments to family caregivers of disabled adults for "attendant care" or "supportive services." *Id.* ¶ 50,439, at 88,264 n.7. The taxpayer in each case was held taxable on these payments, but there was no discussion of possible gift classification because the payments did not come from family members. See *Goldman v. United States*, 79 F. Supp. 2d 1356 (N.D. Ga. 1998), *aff'd*, 196 F.3d 1262 (11th Cir. 1999); *Baldwin v. Commissioner*, 80 T.C.M. (CCH) 431 (2000); *Bannon v. Commissioner*, 99 T.C. 59 (1992).

<sup>92</sup> 2003-1 U.S.T.C. ¶ 50,439, at 88,264.

<sup>93</sup> *Wolder v. Commissioner*, 493 F.2d 608 (2d Cir. 1974).

agreement here that set forth the terms of the exchange, a point that Mary emphasized at trial.<sup>94</sup> The court, however, noted that the burden of proof in this tax refund suit rested with the taxpayer,<sup>95</sup> and that Mary had failed to contradict the government's assertion that an exchange of the house for her elder care services was what the family had intended.<sup>96</sup> Indeed, the Release mentioned above seemed to document this very intention. One of the "whereas" clauses in the Release indicated that "Michael and Mary have asserted . . . that they are entitled to *compensation* for care they provided to Alberta."<sup>97</sup> The Release further stated that in consideration of its terms, which included the conveyance of Alberta's home, Michael and Mary were releasing all "claims for services rendered or care provided . . . including . . . services rendered to or care provided to Alberta."<sup>98</sup> Similarly, the court's order approving the settlement observed that Mary and Michael "had a substantial claim against Alberta L. McNeal for services rendered in taking care of Alberta L. McNeal during [six years]. *This claim is being satisfied* by conveying the former Alberta L. McNeal homestead . . ."<sup>99</sup> Accordingly, the court held that there was no gift, citing the *Duberstein* case<sup>100</sup> that was analyzed previously,<sup>101</sup> and that the home's fair market value must be included in Mary's gross income as compensation for the services that she had rendered.<sup>102</sup>

The really interesting question, however, is how many similar cases never see the light of day. That is, absent an intra-family dispute that manifests itself in public judicial proceedings, how many gratuitous transfers, especially testamentary dispositions, are really tantamount to deferred compensation agreements? Even when one heir receives a disproportionately larger share, on what basis would the Internal Revenue Service suggest that perhaps the rationale for this heir's "extra" portion is that the heir earned it or was entitled to it "for what she/he did for Mom"? Such sentiments, common as they may be, sound in contract and smack of compensation rather than

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<sup>94</sup> 2003-1 U.S.T.C. ¶ 50,439, at 88,264.

<sup>95</sup> *Id.* ¶ 50,439, at 88,263.

<sup>96</sup> *Id.* ¶ 50,439, at 88,264.

<sup>97</sup> *Id.* ¶ 50,439, at 88,260 (emphasis added).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* (emphasis added).

<sup>100</sup> *Id.* ¶ 50,439, at 88,264 (citing *Commissioner v. Duberstein*, 363 U.S. 278 (1960)).

<sup>101</sup> *See supra* Part III.A.1.

<sup>102</sup> 2003-1 U.S.T.C. ¶ 50,439, at 88,264.

donative intent. In other words, such dispositive provisions are very similar in economic terms to the arrangement that Mr. Wolder attempted with his bequest-for-fees plan.<sup>103</sup> Of course, Mr. Wolder was not the natural object of the putative donor's bounty (nor was Mr. Duberstein,<sup>104</sup> for that matter), so it was more likely that the government would question the gratuitous nature of what he received. In the family context, it will often be much more difficult to prove that what looks like a bequest was essentially a delayed payment for elder care services that the recipient had provided to the decedent. That may, however, be the more appropriate characterization of what transpired — as the *Dieter* case demonstrated.

### C. Caregiver Compensation Agreements

An issue that Mary Dieter raised too late in the proceedings was whether the value of the house that she received overstated the amount of compensation that she earned.<sup>105</sup> That is, the house may in fact have been part-compensation and part-gift. In that circumstance, she would have owed income tax on the compensation portion, but *only* on that portion of the home's fair market value. The court dismissed this possibility primarily because it was "untimely,"<sup>106</sup> but also because the express agreement of the parties treated the entire home as compensation,<sup>107</sup> even though no time records were kept nor any other details of the services that Mary had provided. If a caregiver agreement had existed that specified the amount of compensation that was owed to Mary for work that she had done, the court could have bifurcated the receipt of the home into compensatory and gift portions. In other words, the presence of a compensation agreement might have mitigated Mary's tax burden once the essential entitlement to some compensation income was established.

The question, therefore, is whether family caregivers ought to formalize their elder care responsibilities into a written employment agreement.<sup>108</sup> The visceral reaction of most taxpayers and their advisors is probably negative. Rather than seek "half a loaf," as it

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<sup>103</sup> See *Wolder v. Commissioner*, 493 F.2d 608 (2d Cir. 1974).

<sup>104</sup> See *Commissioner v. Duberstein*, 363 U.S. 278 (1960).

<sup>105</sup> See 2003-1 U.S.T.C. ¶ 50,439, at 88,264.

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> See generally Natalie A. Simon, *Legal Considerations in Hiring In-Home Caregivers*, ELDERLAW REP., May 1996, at 1.

were, and recognize a portion of the amount that was received as compensation, most folks will want to gamble that the entire amount will be treated as a tax-free gift or inheritance. In fact, one practitioner-oriented column in a prominent tax journal advises that language in wills should not even reference an heir's past caregiving of the decedent.<sup>109</sup> Such language is often inserted to forestall will challenges by other heirs who presumably received smaller inheritances. Recognizing that such references cast the additional inheritance as taxable compensation, the columnists asked, "Which will be the greater danger — the disgruntled sibling or the IRS?"<sup>110</sup> In such a tax-focused setting, a formalized caregiver agreement will probably not be desired.

For some families, moreover, the very notion that inter-generational caregiving is a compensable service is abhorrent and contrary to popular norms. They may see such services as obligatory in a moral or even religious sense, or perhaps as a privilege, an opportunity to pay back the love, nurturing, and care that they received decades earlier from the person who is now in their care.<sup>111</sup> This issue will undoubtedly present cultural conflicts as different generations espouse different values, but the point remains that for reasons of filial responsibility, many taxpayers will eschew formal caregiver agreements.

Such agreements should not be casually dismissed, however. A caregiver agreement, complete with enumerated responsibilities and stipulated payment amounts, can establish that part — and *only part* — of an intra-family transfer should be taxable. For example, if the relationship between Mr. Wolder, the attorney, and his client had been close personally, it is conceivable that some part of his bequest could have been received tax-free. That is, if he could have shown that his billings would have been  $x$  dollars, then the excess of the property value received over  $x$  would be free of income tax. Similarly, if Mary Dieter had referenced a caregiver agreement with rates that were consistent with elder care service charges in her local community, the excess of the value of Alberta's home over the sum of

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<sup>109</sup> Burgess J.W. Raby & William L. Raby, *Sentiment or Greed: Gift or Compensation?*, 95 TAX NOTES 1045, 1048 (May 13, 2002).

<sup>110</sup> *Id.*

<sup>111</sup> See generally Usha Narayanan, Note, *The Government's Role in Fostering the Relationship Between Adult Children and Their Elder Parents: From Filial Responsibility Laws to . . . What?, A Cross-Cultural Perspective*, 4 ELDER L.J. 369 (1996).

those service charges would most likely have been a tax-free gift.<sup>112</sup> Thus, by choosing to go for broke, by opting for all-or-nothing treatment, these taxpayers lose the opportunity to salvage some portion of their receipts as tax-free gratuitous transfers.

To be sure, a downside of a caregiver agreement is the obligation to pay income taxes, both federal and state, plus Medicare taxes, and usually Social Security taxes as well, if the annual limitation on those taxes has not already been reached.<sup>113</sup> For most people, this prospect is enough to kill the idea of a caregiver agreement entirely. It will no doubt fall on deaf ears to point out that if they had obtained a job in the compensated work force, perhaps caring for someone else's older relative, the wages that they earned in that job would clearly be subject to all the taxes that were enumerated above. After all, self-provided services are ignored in the U.S. tax system, even when they substitute for services that would be so recognized if they were provided for other people.<sup>114</sup> For example, a house painter who paints her own home does not recognize any taxable income from this self-provided economic benefit.<sup>115</sup>

Similarly, it will no doubt matter very little to most people that paying Social Security and Medicare taxes on compensation for elder care services has offsetting benefits — namely, enhanced Social Security retirement payments in the future<sup>116</sup> and perhaps even

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<sup>112</sup> *But see* I.R.C. § 102(c)(1) (stating that the gift exclusion does not apply to “any amount transferred by or for an employer to, or for the benefit of, an employee.”). Proposed regulations under this section, however, provide an exception for:

extraordinary transfers to the natural objects of an employer's bounty . . . if the employee can show that the transfer was not made in recognition of the employee's employment. Accordingly, section 102(c) shall not apply to amounts transferred between related parties (e.g., father and son) if the purpose of the transfer can be substantially attributed to the familial relationship of the parties and not to the circumstances of their employment.

Prop. Treas. Reg. § 1.102-1(f)(2), 54 Fed. Reg. 630, 631 (Jan. 9, 1989) (emphasis added).

<sup>113</sup> *See supra* notes 39–45 and accompanying text.

<sup>114</sup> *See* BORIS I. BITTKER ET AL., FEDERAL INCOME TAXATION OF INDIVIDUALS ¶ 3.03[2], at 3–11 (3d ed. 2002) (“Despite the importance of imputed income from services performed by taxpayers for themselves and their families, Congress has never sought to tax this source of economic gain.”).

<sup>115</sup> *See id.* ¶ 3.03[1], at 3–10.

<sup>116</sup> Social Security retirement benefits are a function of the earnings of the beneficiary throughout that person's working life. *See* LAWRENCE A. FROLIK &

entitlement to health insurance coverage under Medicare.<sup>117</sup> Most people will discount this possibility, perhaps because they do not fully understand the connection between their payments into these programs and the financial benefits that flow from those payments,<sup>118</sup> or because they are already entitled to those benefits through a spouse<sup>119</sup> or former spouse.<sup>120</sup>

For many people, however, it would be appropriate to note that a taxable “inheritance” is better than no inheritance at all. That is, it is better to receive a bequest on which income taxes are owed than to receive nothing at all.<sup>121</sup> This circumstance can result if the older relative eventually requires more extensive care than the family caregiver can provide and paid care becomes necessary. If the cost of such care exhausts the older relative’s assets, that person’s estate will be essentially empty. In that case, the family caregiver who expected to receive a share of what was left may end up without any inheritance whatsoever.

Most Americans who care for an older relative are unaware that if the need for long-term care becomes more intense, their older relative must pay for such care largely out of his or her own resources.<sup>122</sup> As explained more fully in my article entitled *Cracking the Conundrum: Toward a Rational Financing of Long-Term Care*,<sup>123</sup> the federal

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RICHARD L. KAPLAN, *ELDER LAW IN A NUTSHELL* 286–91 (3d ed. 2003).

<sup>117</sup> Medicare insurance requires that a worker have earned at least forty “quarters of coverage.” *See id.* at 58, 275–78.

<sup>118</sup> *See* Richard L. Kaplan, *Top Ten Myths of Social Security*, 3 *ELDER L.J.* 191, 200–02 (1995); *see also* Alan L. Gustman & Thomas L. Steinmeier, *Imperfect Knowledge of Social Security and Pensions*, 44 *INDUS. REL.* 373, 373–374 (2005).

<sup>119</sup> *See* FROLIK & KAPLAN, *supra* note 116, at 59 (Medicare), 294–99 (Social Security).

<sup>120</sup> *See id.* at 60 (Medicare), 302–04 (Social Security).

<sup>121</sup> Rigorous mathematical proof available upon request.

<sup>122</sup> *See* AM. ASS’N OF RETIRED PERSONS, *THE COSTS OF LONG-TERM CARE: PUBLIC PERCEPTIONS VERSUS REALITY* 9 (2001), available at [http://assets.aarp.org/rgcenter/health/ltc\\_costs.pdf](http://assets.aarp.org/rgcenter/health/ltc_costs.pdf); *see also* METLIFE MATURE MKT. INST., *THE METLIFE LONG-TERM CARE IQ TEST 15* (2004), available at <http://www.metlife.com/WPSAssets/19259518271096551987V1FLTC-IQReport.pdf> (stating that 41% of Americans aged forty to seventy years “believe long-term care is an entitlement that all Americans are eligible for when they reach retirement age”). *See generally* Richard L. Kaplan, *Financing Long-Term Care in the United States: Who Should Pay for Mom and Dad?*, in *AGING: CARING FOR OUR ELDERS* 65, 66 (David N. Weisstub et al. eds., 2001).

<sup>123</sup> Richard L. Kaplan, *Cracking the Conundrum: Toward a Rational Financing of Long-Term Care*, 2004 *U. ILL. L. REV.* 47.

government's health care program for older Americans, Medicare,<sup>124</sup> does not pay for around-the-clock home care,<sup>125</sup> assisted living, or nursing home care for chronic conditions that do not require "skilled care" or that require such care for more than 100 days.<sup>126</sup> Private "medigap" insurance, which generally plugs the holes in Medicare's coverage,<sup>127</sup> is similarly irrelevant to financing long-term care in these settings.<sup>128</sup> Such care *is* covered by long-term care insurance to some extent,<sup>129</sup> but such insurance is a problematic product as presently constituted<sup>130</sup> and fewer than 10% of older Americans have these policies.<sup>131</sup>

As a result of these realities, when most Americans need long-term care that is more medically oriented than what their family members can provide, they pay for it themselves. The most recent data available show that the average rate for home health care provided by a home health care agency is \$18 per hour,<sup>132</sup> a room in an assisted living facility is \$2,524 per month (equivalent to \$30,288 per year),<sup>133</sup> and a semi-private room in a nursing home is \$169 per day (equivalent to \$61,685 per year).<sup>134</sup> As is usually the case, there are considerable variations across geographic regions<sup>135</sup> and specific care settings, but the bottom line is that many older people will exhaust their financial resources paying for the care that they require. When that happens, these elders must turn to a joint federal-state program called Medicaid to obtain coverage of their long-term care expenses.<sup>136</sup>

Medicaid is basically a poverty program; it is the health care

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<sup>124</sup> See generally FROLIK & KAPLAN, *supra* note 116, at 57–90.

<sup>125</sup> See Kaplan, *supra* note 123, at 59.

<sup>126</sup> See *id.* at 61–62.

<sup>127</sup> See generally FROLIK & KAPLAN, *supra* note 116, at 90–96.

<sup>128</sup> See Kaplan, *supra* note 123, at 62.

<sup>129</sup> See generally FROLIK & KAPLAN, *supra* note 116, at 134–49.

<sup>130</sup> See Kaplan, *supra* note 123, at 76–82.

<sup>131</sup> GENERAL ACCOUNTING OFFICE, LONG-TERM CARE INSURANCE: BETTER INFORMATION CRITICAL TO PROSPECTIVE PURCHASERS 3 (2000).

<sup>132</sup> METLIFE MATURE MKT. INST., THE METLIFE MARKET SURVEY OF NURSING HOME & HOME CARE COSTS 2 (2004), available at <http://www.metlife.com/WPSAssets/11704283601096047636V1F2004%20NH%20and%20HC%20Market%20Survey.pdf>.

<sup>133</sup> METLIFE MATURE MKT. INST., THE METLIFE MARKET SURVEY OF ASSISTED LIVING COSTS 2 (2004), available at <http://www.metlife.com/WPSAssets/14190796021098449460V1F2004%20Assisted%20Living%20Survey.pdf>.

<sup>134</sup> METLIFE MATURE MKT. INST., *supra* note 132, at 2.

<sup>135</sup> See *id.* at 7–12; METLIFE MATURE MKT. INST., *supra* note 133, at 6–8.

<sup>136</sup> See Kaplan, *supra* note 123, at 64–65.

component of this country's welfare safety net.<sup>137</sup> As such, it is restricted to persons with few financial resources.<sup>138</sup> Special allowances are provided for married couples,<sup>139</sup> but many older folks who receive family caregiving are without a spouse, either because they never married or because their spouse has predeceased them. Accordingly, to access Medicaid, these older folks must use up all, or almost all, of their financial resources,<sup>140</sup> including retirement accounts<sup>141</sup> and principal residences.<sup>142</sup> Only when they have "spent down" their assets,<sup>143</sup> in the peculiar argot of Medicaid, will they qualify for coverage of the more medicalized forms of long-term care, especially care in a nursing home.

In many family situations, particularly when an eventual nursing home placement is likely, there is a tremendous temptation to have the older relative give away his or her financial assets,<sup>144</sup> usually to family members, and to thereby hasten the day when that person becomes eligible for Medicaid's long-term care coverage. Such transfers are extremely controversial<sup>145</sup> and are often contrary to the

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<sup>137</sup> See generally FROLIK & KAPLAN, *supra* note 116, at 103–33.

<sup>138</sup> See *id.* at 106–18.

<sup>139</sup> See *id.* at 118–25.

<sup>140</sup> The major exceptions are an automobile that is worth no more than \$4,500 (unless it is needed for medical treatment), burial plots and designated burial funds up to \$1,500, and whole life insurance with a face value that does not exceed \$1,500. 42 U.S.C. § 1382b(a)(2)(A), (B), (d) (2005); 20 C.F.R. § 416.1218(b)(2) (2005). In addition, up to \$2,000 of all other assets are ignored. 42 U.S.C. § 1382(a)(3)(B) (2005); 20 C.F.R. § 416.1205(c) (2005).

<sup>141</sup> See William Browning, *Medicaid Treatment of Retirement Plans Revisited*, NAELA Q., Spring 1995, at 16, 18. Individual retirement accounts of a Medicaid recipient's spouse are also subject to Medicaid's limits. See *Houghton v. Reinertson*, 382 F.3d 1162 (10th Cir. 2004); *Mistrick v. Div. of Med. Assistance & Health Servs.*, 712 A.2d 188 (N.J. 1998).

<sup>142</sup> A residence is exempt, however, if the Medicaid recipient has "the intent to return" to it. 42 U.S.C. § 1382b(a)(1) (2005); 20 C.F.R. § 416.1212(b), (c) (2005). If that person's spouse lives in the home, it is also an exempt resource. 42 U.S.C. §§ 1396r-5(c)(5)(A), 1382b(a)(1) (2005); 20 C.F.R. § 416.1212(c) (2005).

<sup>143</sup> See generally ROBERT B. FLEMING, *ELDER LAW ANSWER BOOK* 14-43 to 14-44 (2d ed. 2004).

<sup>144</sup> See Kaplan, *supra* note 122, at 70.

<sup>145</sup> See, e.g., Stephen A. Moses, *Planning for Long-Term Care Without Public Assistance*, J. ACCT., Feb. 1993, at 40, 42; Jan Ellen Rein, *Misinformation and Self-Deception in Recent Long-Term Care Policy Trends*, 12 J.L. & POL. 195 (1996); David M. Rosenfeld, *Whose Decision Is It Anyway?: Identifying the Medicaid Planning Client*, 6 ELDER L.J. 383 (1998); John M. Broderick, Note, *To Transfer or Not to Transfer: Congress Failed to Stiffen Penalties for Medicaid Estate Planning, but Should*

best interests of the older people themselves. As I have explained elsewhere:

It is an open secret that many long-term care facilities limit the number of Medicaid recipients that they will accept, and some institutions do not participate in the program at all. Recent trends towards ever-lower Medicaid rates paid by the government reduce further the number of places available to Medicaid recipients. Thus, not only does one's status as a Medicaid recipient limit his initial choice of nursing facilities, but if the quality of care deteriorates at his facility, being a Medicaid recipient might affect that person's ability to move elsewhere.<sup>146</sup>

On the other hand, many families see the choice as the elder's money going either to the nursing home or to loved ones. Framing the issue in this way makes transferring assets to relatives an easy decision.

The Medicaid statute, however, has very strict penalties for such asset transfers. Any transfer that is made within thirty-six months of applying for Medicaid makes the transferor ineligible for a number of months,<sup>147</sup> depending upon the specific formula that is employed by the state in which the transferor resides. Most states employ a statewide or countywide average of nursing home rates to derive the penalty.<sup>148</sup> The transferred amount is then divided by the specific state's divisor,<sup>149</sup> and the resulting number represents the number of months during which the transferor is ineligible for Medicaid coverage of long-term care.<sup>150</sup>

For example, assume that Paula transfers \$200,000 on February 1, 2006 and applies for Medicaid on March 1, 2007. The \$200,000 transfer was within 36 months of Paula's applying for Medicaid, so a transfer-of-assets penalty will be assessed. Assume further that the average cost of nursing home care in Paula's state is \$4,000 per month. Dividing the \$200,000 transfer amount by this average cost yields a

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*the Practice Continue?*, 6 ELDER L.J. 257 (1998); Jeffrey L. Soltermann, *Medicaid and the Middle Class: Should the Government Pay for Everyone's Long-Term Health Care?*, 1 ELDER L.J. 251 (1993).

<sup>146</sup> Kaplan, *supra* note 123, at 72 (footnotes omitted).

<sup>147</sup> 42 U.S.C. § 1396p(c)(1)(A), (B)(i), (ii)(I) (2005).

<sup>148</sup> *Id.* § 1396p(c)(1)(E)(i)(II). For a current listing of the applicable monthly rates that are used by the various states, see ERIC M. CARLSON, LONG-TERM CARE ADVOCACY § 7.401 (2004).

<sup>149</sup> 42 U.S.C. § 1396p(c)(1)(E)(i) (2005).

<sup>150</sup> *Id.*

penalty period of 50 months. As a result, Paula is ineligible for Medicaid benefits for 50 months from the date on which she transferred her assets — until April 1, 2010, in this case. This rather draconian penalty applies, moreover, whether Paula gave her \$200,000 to a single loved one or spread this amount amongst a passel of relatives.

There are a few finely calibrated exceptions to Medicaid's transfer-of-assets penalty,<sup>151</sup> one of which is that a Medicaid applicant may transfer her home to an adult child who had: (1) lived there with the Medicaid applicant for at least two years, and (2) "provided care to such individual which permitted such individual to reside at home rather than in" a nursing facility.<sup>152</sup> In effect, the adult child is treated as having "earned" the home as compensation for the services that he or she provided. Few people know in advance that they will meet the full two-year requirement, and there is no exception for partial satisfaction.

A more general exception, however, applies whenever the transferor receives "fair market value" for the assets that were transferred.<sup>153</sup> That is, if Paula in the preceding example had received something of value in exchange for the amount that she transferred, the penalty rules would not apply and her eligibility for Medicaid benefits would not be affected. It is in this context that a family caregiver agreement may be very advantageous. Such an agreement can establish what services an elder is receiving, and as long as these services are in fact provided and the specified compensation rates do not exceed local third-party charges, the assets that are transferred to the caregiver will be "for value received" and therefore not subject to Medicaid's penalty rules.<sup>154</sup> But in such circumstances, a written agreement is critical. The federal agency that administers the Medicaid program, the Centers for Medicare and Medicaid Services, states its position on this issue as follows:

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<sup>151</sup> See *id.* § 1396p(c)(2)(A)(i)–(iii) (excepting transfers of the principal residence to the Medicaid applicant's spouse, minor child, and a co-owning sibling). See generally CARLSON, *supra* note 148, § 7.12[6][c]–[e].

<sup>152</sup> 42 U.S.C. § 1396p(c)(2)(A)(iv) (2005).

<sup>153</sup> *Id.* § 1396p(c)(1)(A).

<sup>154</sup> See *Thomas v. Fla. Dep't of Children & Families*, 707 So. 2d 954 (Fla. Dist. Ct. App. 1998); see also THOMAS D. BEGLEY, JR. & JO-ANNE HERINA JEFFREYS, REPRESENTING THE ELDERLY CLIENT: LAW AND PRACTICE § 8.05[B][6] (1999); CARLSON, *supra* note 148, § 7.12[6][b][ii]. See generally NAELA Institute Recording, "Personal Care Contract" by Scott Solkoff & Nicola J. Boone (Nov. 1998) (on file with author).

[W]hile relatives and family members legitimately can be paid for care they provide to the individual, [the agency] presumes that services provided for free at the time were intended to be provided without compensation. . . . However, an individual can rebut this presumption with tangible evidence. . . [such as] a payback *arrangement* [that] had been agreed to *in writing at the time services were provided*.<sup>155</sup>

Clearly, a compensation agreement should be in place when the family caregiver is providing the appropriate services.<sup>156</sup>

To summarize, a caregiver compensation agreement enables an older person to transfer resources to a family caregiver without affecting the older person's potential eligibility for Medicaid coverage of long-term care expenses. The family caregiver will, however, be subject to federal and state income taxes, as well as the Social Security and Medicare taxes that are imposed on income from compensation for services rendered. But if no caregiving agreement exists, an elder's resources may be completely exhausted by the cost of long-term care, resulting in the depletion of the elder's estate and no inheritance at all for the caregiver. And in situations in which Medicaid coverage for long-term care is not anticipated, a caregiver agreement can establish the maximum amount of an inheritance that will be treated as compensation, with any excess amount received over this sum probably resulting in a tax-free gift or bequest. In other words, family caregivers who forego a formal compensation agreement risk receiving less than they expect on an after-tax basis, and perhaps nothing at all if the older person subsequently requires more medically intensive long-term care. Thus, such agreements merit serious consideration rather than unreflective rejection.

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<sup>155</sup> CTRS. FOR MEDICARE & MEDICAID SERVS., STATE MEDICAID MANUAL § 3258.1 (2004), available at [http://www.cms.hhs.gov/manuals/45\\_smm/sm\\_03\\_3\\_toc.asp](http://www.cms.hhs.gov/manuals/45_smm/sm_03_3_toc.asp) (emphasis added).

<sup>156</sup> For some drafting suggestions for such agreements, see CARLSON, *supra* note 148, § 7.12[6][b][ii][B]; Donna S. Harkness, *Life Care Agreements: A Contractual Jekyll and Hyde?*, 5 MARQ. UNIV. ELDER'S ADVISOR 39, 48-51 (2003); Scott M. Solkoff, *The Personal Service Contract in Long-Term Care Planning*, ELDERLAW REP., Apr. 1998, at 1, 2-5. For a comprehensive family caregiving agreement, see Thomas D. Begley, Jr., *Forms for Advanced Medicaid Planning*, ELDERLAW REP., July/Aug. 1998, at 6, 7-10.

## IV. PERSONAL EXEMPTIONS AND MEDICAL EXPENSE DEDUCTIONS

This Part analyzes two features of the current federal tax code that might benefit family providers of elder care: the personal exemption<sup>157</sup> and the deduction of medical expenses.<sup>158</sup> Though these provisions are well-known and of long standing, their application in the context of family-provided elder care has received relatively little attention.

*A. Personal Exemptions*

Internal Revenue Code section 151(a) authorizes the deduction of a “personal exemption” in an amount that is adjusted annually for inflation.<sup>159</sup> In 2005, this amount was \$3,200.<sup>160</sup> Though this amount is hardly large, its actual value depends upon the tax bracket of the taxpayer who claims this deduction. Thus, the tax savings that the personal exemption actually produces will range from nothing at all, if the claiming taxpayer has no tax liability that year, to \$320 for a taxpayer in the 10% tax bracket, to perhaps as much as \$1,120 to someone who is in the highest tax bracket, which is currently 35%.<sup>161</sup> Accordingly, the benefit of the personal exemption varies considerably among taxpayers, depending upon the totality of their individual tax circumstances, including other deductions, investment income, and the like.

Although the value of the personal exemption would seem to be greatest for higher-income taxpayers, its value for such taxpayers is largely undercut by a complicated phase-out mechanism<sup>162</sup> that has been part of the tax code since 1990.<sup>163</sup> Designed as a surreptitious way of raising taxes on upper-income taxpayers without raising nominal tax rates, this phase-out mechanism starts when a taxpayer’s “adjusted gross income” (AGI)<sup>164</sup> reaches certain specified levels.<sup>165</sup>

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<sup>157</sup> I.R.C. § 151. *See generally* BITTKER ET AL., *supra* note 114, ¶ 21.01.

<sup>158</sup> I.R.C. § 213. *See generally* BITTKER ET AL., *supra* note 114, ¶ 26.01.

<sup>159</sup> I.R.C. § 151(d)(4)(A).

<sup>160</sup> Rev. Proc. 2004-71, § 3.17(1), 2004-50 I.R.B. 970, 974.

<sup>161</sup> *See* I.R.C. § 1(i)(2).

<sup>162</sup> *Id.* § 151(d)(3).

<sup>163</sup> *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11104(a), 104 Stat. 1388, 1388-407 to 1388-408, *amending* I.R.C. § 151(d).

<sup>164</sup> I.R.C. §§ 62(a), 151(d)(3)(A). As to the composition of “adjusted gross income” (AGI), *see generally* BITTKER ET AL., *supra* note 114, ¶ 2.01[3].

<sup>165</sup> I.R.C. § 151(d)(3)(C).

These levels are also adjusted annually for inflation:<sup>166</sup> in 2005, they were \$145,950 for single taxpayers, \$182,450 for people who file as a “head of household,” and \$218,950 for married taxpayers who file a joint return.<sup>167</sup> The phase-out mechanism is graduated according to income and is essentially 2% of the exemption for each \$2,500 (or fraction thereof) of income above the threshold amounts that were just specified.<sup>168</sup> As a result, the entire exemption is lost (i.e., 100%) when income above the threshold exceeds \$122,500.<sup>169</sup> In other words, no personal exemption was available in 2005 once a taxpayer’s AGI exceeded \$268,450 (singles), \$304,950 (heads of household), or \$341,450 (marrieds filing jointly) in 2005.<sup>170</sup>

This phase-out mechanism is ameliorated starting in 2006 so that only two-thirds of the reduction that would otherwise be applicable is actually taken.<sup>171</sup> In 2008, only one-third of the reduction that would otherwise be applicable is actually taken,<sup>172</sup> and in the year 2010, this noxious phase-out mechanism is eliminated.<sup>173</sup> As presently constituted, however, the phase-out mechanism then returns in the year 2011 in all of its unreduced glory.<sup>174</sup> But the point remains that the personal exemption amount is only \$3,200 (in 2005), and even that amount is reduced, and in some cases eliminated entirely, once a taxpayer’s income exceeds certain thresholds that depend upon an individual taxpayer’s overall income and filing status.

Be that as it may, one personal exemption is allowed for the taxpayer, that person’s spouse, and for each “dependent.”<sup>175</sup> It is this

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<sup>166</sup> *Id.* § 151(d)(4)(B).

<sup>167</sup> Rev. Proc. 2004-71, § 3.17(2), 2004-50 I.R.B. 970, 974. The threshold for married persons who file separate returns was \$109,475. *Id.*

<sup>168</sup> I.R.C. § 151(d)(3)(B). For those married filing separately, 2% is lost for every \$1,250 of income. *Id.*

<sup>169</sup> Since a fraction of \$2,500 triggers a 2% reduction, the entire exemption is lost once the 98% level is exceeded. This level (i.e., 98%) is divided by 2% to yield forty-nine reductions, which requires income of \$122,500 (49 x \$2,500).

<sup>170</sup> Rev. Proc. 2004-71, § 3.17(2), 2004-50 I.R.B. 970, 974. The threshold for married persons who file separate returns was \$170,725. *Id.*

<sup>171</sup> I.R.C. § 151(d)(3)(E), added by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 102(a), 115 Stat. 38, 44 [hereinafter EGTRRA].

<sup>172</sup> I.R.C. § 151(d)(3)(E).

<sup>173</sup> *Id.* § 151(d)(3)(F), added by EGTRRA, *supra* note 171, § 102(a), 115 Stat. at 38, 44.

<sup>174</sup> *See* EGTRRA, *supra* note 171, § 901, 115 Stat. at 150. This provision “sunsets” or terminates all provisions of EGTRRA after the year 2010.

<sup>175</sup> I.R.C. § 151(b), (c).

last category that has significance for family caregivers, because they must determine whether their older relative qualifies as a “dependent” for federal income tax purposes.<sup>176</sup> This determination is a major issue for three distinct reasons, only one of which is eligibility for the personal exemption that is being discussed here. A second reason is that the tax rate schedule for a “head of household”<sup>177</sup> is more favorable than the rate schedule that applies to single taxpayers,<sup>178</sup> so unmarried taxpayers will usually want to qualify for “head of household” status.<sup>179</sup> And the principal requirement to be a “head of household” is that the taxpayer provide a household for someone who qualifies as that taxpayer’s “dependent.”<sup>180</sup> Furthermore, if the putative dependent is “the father or mother of the taxpayer,” this household must be that person’s “principal place of abode” for the taxable year in question.<sup>181</sup> The third reason is that “dependent” status is required if the taxpayer is to be eligible to deduct the older person’s medical expenses,<sup>182</sup> as will be considered next in this Part. In other words, whatever tax benefits will flow to a family provider of elder care will depend upon the care recipient’s status as that caregiver’s dependent.

<sup>176</sup> See *id.* § 152(d).

<sup>177</sup> See *id.* § 2(b). See generally BITTKER ET AL., *supra* note 114, ¶ 44.02[4].

<sup>178</sup> See Rev. Proc. 2004-71, § 3.01 tbls. 2 & 3, 2004-50 I.R.B. 970, 971–72. For example:

Taxable Income	Marginal Rate	
	Head of Household	Single
\$35,000	15	25
\$75,000	25	28
\$155,000	28	33

There is no marginal tax rate difference once taxable income exceeds \$166,450 (in 2005), but the rate advantages at lower-income levels continue to provide a tax benefit.

<sup>179</sup> Only an unmarried individual can qualify as a “head of household.” I.R.C. § 2(b)(1).

<sup>180</sup> *Id.* § 2(b)(1)(A)(ii).

<sup>181</sup> *Id.* § 2(b)(1)(B). In addition, the taxpayer must furnish “over half of the cost of maintaining the household.” *Id.*

<sup>182</sup> *Id.* § 213(a). Dependency status is also relevant for certain provisions that are not considered in this article, such as the credit for part of the “employment-related expenses” incurred by a taxpayer to care for someone who “has the same principal place of abode as the taxpayer for more than one-half of [the] taxable year” and the exclusion for employer-provided dependent care assistance. *Id.* §§ 21(a), (b)(1)(B), (C), (c)(1), 129(a)(1). See generally BITTKER ET AL., *supra* note 114, ¶¶ 27.04[2], 8.04.

To qualify as a “dependent,” three separate tests must be satisfied, and these tests are often described as: (1) qualifying relation, (2) support, and (3) income.<sup>183</sup> The first of these tests is fairly straightforward and usually poses no problem for family providers of elder care. Included among the eligible relations are “[t]he father or mother, or an ancestor of either”<sup>184</sup> (i.e., a grandparent), “[a] stepfather or stepmother,”<sup>185</sup> the taxpayer’s father-in-law and mother-in-law,<sup>186</sup> and the taxpayer’s aunts and uncles.<sup>187</sup> The other two tests, however, are much more problematic and are examined below.

### 1. Support Test

Section 152(d)(1)(C) states rather cryptically that a “dependent” is someone “to whom the taxpayer provides over one-half of the individual’s support” and then provides precious little guidance on how this seemingly mathematical determination is made. One mechanism that applies to some family caregiving situations is the “multiple support agreement” authorized by section 152(d)(3). Under this provision, a taxpayer can be treated as providing the requisite level of support as long as four separate conditions are satisfied:

- “[N]o one person contributed over one-half of such support . . . .”<sup>188</sup>
- “[O]ver one-half of such support was received from 2 or more persons”<sup>189</sup> who meet one of the qualifying relationships that are required for dependency status.<sup>190</sup>
- “[T]he taxpayer contributed over 10 percent of such support . . . .”<sup>191</sup>
- Each person (other than the taxpayer) “who contributed over 10 percent of such support files a written declaration . . . that such person will not claim such

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<sup>183</sup> I.R.C. § 152(d)(1)(A)–(C).

<sup>184</sup> *Id.* § 152(d)(2)(C).

<sup>185</sup> *Id.* § 152(d)(2)(D).

<sup>186</sup> *Id.* § 152(d)(2)(G).

<sup>187</sup> *Id.* § 152(d)(2)(F).

<sup>188</sup> *Id.* § 152(d)(3)(A).

<sup>189</sup> *Id.* § 152(d)(3)(B).

<sup>190</sup> *See id.* § 152(d)(2).

<sup>191</sup> *Id.* § 152(d)(3)(C).

individual as a dependent.”<sup>192</sup>

Such agreements can be useful if, for example, Mom lives with her daughter while each of her two sons provides approximately one-third of Mom’s support. In that circumstance, the daughter could claim Mom as her dependent, as long as her brothers agree in writing<sup>193</sup> not to do so. But this “multiple support agreement” mechanism still leaves unanswered the crucial questions of what constitutes support and how the source of that support is determined.

The remaining statutory guidance and most of the reported cases deal with minor children,<sup>194</sup> rather than impaired senior citizens who are living with their adult children. The regulations, however, define “support” to include “food, shelter, clothing, medical and dental care, education, and the like.”<sup>195</sup> They further note that in making the “over half” calculation, an item of support is tabulated using “the amount of *expense incurred* by the one furnishing such item.”<sup>196</sup> And, for the all-important support item of housing, the regulations advise that “it will be necessary to measure the amount . . . in terms of its fair market value.”<sup>197</sup> Thus, if Ann is furnishing a home for her father, the fair rental value of his dwelling unit will be the critical amount in question, rather than Ann’s out-of-pocket expenses for property taxes, utilities, and general home maintenance. Notwithstanding the clarity of this rule, it is often difficult to implement, because there usually is little information about the rental value for lodging that is comparable to living in most people’s family residences.

For the bulk of support expenses, however, out-of-pocket costs are the relevant metric. So, for example, the allocated cost of Ann’s groceries would be used in determining the value of her support, rather than the restaurant value of her gourmet preparations.<sup>198</sup> Similarly, the Seventh Circuit Court of Appeals has ruled that taxpayers may not count the value of their unpaid services in caring for an impaired relative, because no out-of-pocket expense was involved.<sup>199</sup> This holding has particular significance to the context

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<sup>192</sup> *Id.* § 152(d)(3)(D).

<sup>193</sup> For the mechanics of the declaration requirement, see Treas. Reg. § 1.152-3(c)(1), (2) (as amended in 2002 and 2003).

<sup>194</sup> See BITTKER ET AL., *supra* note 114, ¶ 21.02[3][a] & n.31.

<sup>195</sup> Treas. Reg. § 1.152-1(a)(2)(i) (1971).

<sup>196</sup> *Id.* (emphasis added).

<sup>197</sup> *Id.*

<sup>198</sup> See BITTKER ET AL., *supra* note 114, ¶ 21.02[3][b].

<sup>199</sup> *Markarian v. Commissioner*, 352 F.2d 870, 872 (7th Cir. 1965).

being examined here — namely, elder care that is provided free of charge by family members.

Once the items of “support” are determined and a cost or value is assigned to their provision, it is necessary to determine *who* provided this support. Only then can the “over one-half” calculation be made. Doing so in the context of elder care, however, is more problematic than the typical dependency context involving minor children, because most older adults have their own sources of income. Thus, one must determine how much “support” was provided by others (especially the family caregiver) and how much was provided by the older person him- or herself. In this connection, the regulations note that a putative dependent’s income includes receipts that are not taxable and provides the following example:

[A] father receives \$800 social security benefits, \$400 interest, and \$1,000 from his son during [the year], all of which sums represent his sole support during that year. The fact that the social security benefits of \$800 are not includible in the father’s gross income does not prevent such amount from entering into the computation of the total amount contributed for the father’s support. Consequently, since the son’s contribution of \$1,000 was less than one-half of the father’s support (\$2,200) he may not claim his father as a dependent.<sup>200</sup>

This rule is extremely important in the elder care context, because Social Security constitutes the majority of income for two-thirds of current recipients of such benefits.<sup>201</sup> Furthermore, only two out of five such recipients owe any federal income tax on their Social Security benefits,<sup>202</sup> because those benefits are tax-free until a recipient’s adjusted gross income, plus one-half of those benefits, exceeds \$25,000 (or \$32,000 for married recipients).<sup>203</sup> Even then, only a *portion* of Social Security benefits are subject to federal income tax,

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<sup>200</sup> Treas. Reg. § 1.152-1(a)(2)(ii) (1971).

<sup>201</sup> OFFICE OF RESEARCH, EVALUATION & STATISTICS, SOC. SEC. ADMIN., FAST FACTS & FIGURES ABOUT SOCIAL SECURITY, 2004, at 7 (2004), *available at* [http://www.ssa.gov/policy/docs/chartbooks/fast\\_facts/2004/ff2004.pdf](http://www.ssa.gov/policy/docs/chartbooks/fast_facts/2004/ff2004.pdf).

<sup>202</sup> CHRISTINE SCOTT, CONG. RESEARCH SERV., SOCIAL SECURITY: CALCULATION AND HISTORY OF TAXING BENEFITS 9 (2005), *available at* <http://www.lawprofessorblogs.com/taxprof/linkdocs/CRS.pdf>.

<sup>203</sup> I.R.C. § 86(b)(1)(A), (b)(2), (c)(1)(A), (c)(1)(B). For married persons who file separately, the relevant threshold is zero. *Id.* § 86(c)(1)(C). These thresholds are *not* adjusted for inflation.

with this portion increasing as income rises.<sup>204</sup> Nevertheless, an older adult's *entire* Social Security benefit is counted when determining his or her level of self-support,<sup>205</sup> regardless of the taxability of those benefits in the particular situation at hand.

The bottom line here is that the support test for dependency status is not a slam dunk in the context of older adults. All of their income must be counted even when they owe no income tax on some or all of these receipts. The value of care that is provided by the family member is ignored, and the rental value of the caregiver's home must somehow be determined, rather than simply allocating a portion of that home's out-of-pocket expenses. And if the family caregiver moves into the *elder's* home to provide care there, which is not at all uncommon, the value of this residence becomes a major item of self-support. As a consequence, many family caregivers may not in fact be entitled to claim their older relative as a dependent for income tax purposes. Even if they meet this "support" test, moreover, another hurdle awaits.

## 2. Income Test

The third test for a "dependent" may be the most problematic in the context of family caregiving — namely, that the putative dependent has "gross income" that "is less than the exemption amount."<sup>206</sup> In other words, all sources of taxable income must be aggregated, including such typical sources of older people's income as interest on certificates of deposit and savings accounts,<sup>207</sup> dividends on stocks and mutual funds,<sup>208</sup> pension payments,<sup>209</sup> annuities,<sup>210</sup> capital gains on sales of investment assets (including collectibles, such as gold and silver coins),<sup>211</sup> and withdrawals from individual retirement accounts<sup>212</sup> and so-called 401(k) retirement savings plans.<sup>213</sup> Moreover,

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<sup>204</sup> *Id.* § 86(a)(1). For an illustration of how this provision applies, see FROLIK & KAPLAN, *supra* note 116, at 312–14.

<sup>205</sup> Treas. Reg. § 1.152-1(a)(2)(ii) (1971); *see also* Alisobhani v. Commissioner, 68 T.C.M. (CCH) 1493 (1994) (holding that Supplemental Security Income payments are treated as recipient's self-support).

<sup>206</sup> I.R.C. § 152(d)(1)(B).

<sup>207</sup> *Id.* § 61(a)(4).

<sup>208</sup> *Id.* § 61(a)(7).

<sup>209</sup> *Id.* § 61(a)(11).

<sup>210</sup> *Id.* § 61(a)(9).

<sup>211</sup> *Id.* § 61(a)(3).

<sup>212</sup> *Id.* § 408(d)(1).

a sizeable minority of Social Security recipients must include some portion of their Social Security benefits, as noted previously.<sup>214</sup> If this sum exceeds the exemption amount, which in 2005 was \$3,200,<sup>215</sup> no one — including the family caregiver — may claim this person as his or her “dependent” for income tax purposes. Note that the preferential tax rates of 5% and 15% that apply to most dividends and long-term capital gains<sup>216</sup> are irrelevant in this determination. The *entire* amount of those income sources is counted, with no special allowance for their otherwise-favored tax status.

An annual threshold of \$3,200 for income from all sources is really quite low, less than \$300 per month. As a consequence, many older adults will have too much income to be claimed as the dependent of their family caregiver, regardless of how extensive those caregiving responsibilities may be.

On the other hand, a failure to pass the income test does *not* prevent the family caregiver from deducting the older relative’s medical expenses. Section 213(a) authorizes the deduction of such expenses for a “taxpayer, his spouse, or a dependent (as defined in section 152, determined without regard to subsection[] . . . (d)(1)(B) thereof).”<sup>217</sup> As the leading treatise in this area explains, “[a] taxpayer who provides more than half of the support of elderly parents . . . can deduct medical expenses paid for them . . . , even though they each have gross income in excess of the exemption amount and therefore do not give rise to dependency exemptions.”<sup>218</sup> The scope and limitations of that deduction are examined in the next segment of this Part.<sup>219</sup>

### 3. Summary

The tax benefits of the personal exemption for family providers of elder care are like the old Catskills complaint that the food tastes bad and the portions are small. Proving that a family caregiver provided over one-half of the support of his or her impaired elder is often

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<sup>213</sup> *Id.* §§ 401(a), (k), 402(a).

<sup>214</sup> See SCOTT, *supra* note 202.

<sup>215</sup> Rev. Proc. 2004-71, § 3.17(1), 2004-50 I.R.B. 970, 974.

<sup>216</sup> See I.R.C. § 1(h)(1)(B) (5% for taxpayers in the 10% and 15% tax brackets), (C) (15% for all others). See generally BITTKER ET AL., *supra* note 114, ¶ 31.02[2][b] (Supp. 2005).

<sup>217</sup> I.R.C. § 213(a).

<sup>218</sup> BITTKER ET AL., *supra* note 114, ¶ 21.02[1], at 21-7 (footnote omitted).

<sup>219</sup> See *infra* Part IV.B.

problematic due to various uncertainties that involve the valuation of key support items and the presence of the older relative's own sources of income. Those sources of income, in turn, make qualifying as a dependent extremely difficult due to the low maximum that is allowed under the annual income test. And if the family caregiver can claim the older relative as a dependent, the value of the personal exemption is relatively small and is determined entirely by the caregiver's overall tax position. Finally, at the level of income where the personal exemption has some genuine value, a nasty phase-out mechanism in the current law destroys much, and sometimes all, of that value.

### *B. Medical Expense Deductions*

The tax law permits the deduction of expenses that are paid "for medical care" of the taxpayer and any person who satisfies both the qualifying relation test and the support test for "dependent" status,<sup>220</sup> as explained above. This deduction, however, has three distinct barriers that result in much less tax benefit being realized than many taxpayers expect: first, it is an itemized deduction; second, it has a percentage-of-AGI floor; and third, only certain medical expenses may be deducted. This Part IV.B. examines each of these three barriers.

#### 1. Itemized Deduction

The deduction for medical expenses is allowed *from* AGI,<sup>221</sup> a condition that is usually described as requiring "itemization," or more colloquially as being "below the line." In this context, the "line" refers to a taxpayer's AGI, and the consequence is that only those taxpayers who forego claiming the standard deduction may deduct medical expenses.<sup>222</sup> The standard deduction,<sup>223</sup> in turn, increases annually for inflation<sup>224</sup> and in 2005 was \$5,000 for singles, \$7,300 for a "head of household," and \$10,000 for married persons who file jointly.<sup>225</sup> An additional standard deduction of \$1,250 (in 2005)<sup>226</sup> is

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<sup>220</sup> I.R.C. § 213(a).

<sup>221</sup> *See id.* §§ 62(a) (the list of deductions to AGI does not include the medical expense deduction), 63(d)(1).

<sup>222</sup> *See id.* § 63(b)(1). *See generally* BITTKER ET AL., *supra* note 114, ¶ 21.04[1].

<sup>223</sup> I.R.C. § 63(c).

<sup>224</sup> *Id.* § 63(c)(4).

<sup>225</sup> Rev. Proc. 2004-71, § 3.10(1), 2004-50 I.R.B. 970, 973. Married folks who file separately may claim \$5,000 in 2005. *Id.*

allowed to any taxpayer who is at least sixty-five years old by the end of the taxable year.<sup>227</sup> The result of these allowances is that almost two out of three taxpayers opt for the standard deduction and forego claiming any itemized deductions,<sup>228</sup> including the one for medical expenses.

For older Americans, this situation is even starker. Fully one-half of all Americans who are age sixty-five and older have no income tax liability,<sup>229</sup> with the result that a deduction for medical expenses is meaningless to them. Of the remaining half, most have either paid off their home's mortgage or are renting; as a result, they have no tax deduction for home mortgage interest expense.<sup>230</sup> Consequently, it is less likely that the sum of the other typically available itemized deductions — namely, medical expenses, charitable contributions,<sup>231</sup> and state taxes<sup>232</sup> — will exceed the standard deduction that is available. And even if these deductions exceed the standard deduction, only the *excess* of those deductions over the standard deduction actually reduces the taxpayer's tax burden.

Consider Janice, an older homeowner, who has the following deductible expenses:

Property taxes	\$2,000
State income tax	1,000
Charitable contributions	1,000
Medical expenses	<u>3,000</u>
Total	<u>\$7,000</u>

Janice is entitled to a standard deduction of \$6,250 (in 2005), consisting of the \$5,000 that is generally allowed to a single person,

<sup>226</sup> *Id.* § 3.10(3), at 973–74. The amount for a married person is \$1,000 (in 2005). *Id.* § 3.10(3), at 973.

<sup>227</sup> I.R.C. § 63(c)(3), (f)(1)(A), (f)(3).

<sup>228</sup> See BRIAN BALKOVIC, INTERNAL REVENUE SERV., INDIVIDUAL INCOME TAX RETURNS, PRELIMINARY DATA, 2003, at 8 (65% did not itemize deductions), available at <http://www.irs.gov/pub/irs-soi/03inplim.pdf>.

<sup>229</sup> See JOHN GIST, AARP PUB. POLICY INST., A PROFILE OF OLDER TAXPAYERS 1 (2002), available at [http://assets.aarp.org/rgcenter/econ/dd76\\_taxpayers.pdf](http://assets.aarp.org/rgcenter/econ/dd76_taxpayers.pdf).

<sup>230</sup> See I.R.C. § 163(h)(2)(D), (h)(3)(B). Older homeowners might, however, have home equity indebtedness, which would generate income tax deductions for the interest expense of such debt. *Id.* § 163(h)(3)(C). But interest on a “reverse mortgage” is not deductible until the homeowner leaves the residence and pays the accumulated indebtedness. See FROLIK & KAPLAN, *supra* note 116, at 205–06, 209.

<sup>231</sup> I.R.C. § 170(a)(1).

<sup>232</sup> *Id.* § 164(a)(2), (3).

plus the \$1,250 additional allowance for a taxpayer who is at least sixty-five years old. Since Janice's deductions exceed this amount, she will "itemize" her deductions, including the \$3,000 of medical costs. But because Janice could have deducted \$6,250 in any case, only the excess of her deductions over this amount — \$750, in other words — actually lowers her tax bill. To put it bluntly, although Janice deducted \$3,000 of medical expenses, only \$750 of those expenses produced any additional tax benefit. Even this benefit, moreover, may be lost in future years if the inflation-based increases in the standard deduction outpace any increases in Janice's itemized deductions.

The situation for the family caregiver is similar but different in several possible respects. The basic concept remains that only the excess of itemized deductions over a taxpayer's standard deduction produces any tax benefit. But family caregivers have a lower threshold to clear, because they usually are not yet sixty-five years old, so they are not entitled to the additional standard deduction of \$1,250 (in 2005). In addition, these people are often still paying a mortgage on their residence, with the result that they have itemized deductions for home mortgage interest expense. Therefore, it is possible that much, or even all, of an additional deduction for medical expenses will lower their taxable income and therefore their tax liability.

## 2. Percent-of-AGI Floor

The second major barrier that the medical expense deduction poses is the limitation in section 213(a) that these expenses are deductible only "to the extent that [they] exceed 7.5 percent of adjusted gross income."<sup>233</sup> Thus, if Eric has medical expenses of \$4,000 but his AGI is \$50,000, he can deduct only the excess of those expenses over 7.5% of \$50,000, which is \$3,750. In other words, medically related expenditures of \$4,000 yield a medical expense deduction of only \$250. To be sure, once the AGI threshold has been reached, any additional medical costs increase the allowable deduction dollar for dollar. The contrary result happens, however, with additional income. For example, assume that after the taxable year ends, Eric receives a Form 1099 from one of his mutual funds that shows a reinvested distribution for the year just ended of \$2,000. In this circumstance, his AGI increases to \$52,000 and his medical

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<sup>233</sup> I.R.C. § 213(a).

expense deduction declines to only \$100.<sup>234</sup> Clearly, medical expenses must exceed a fairly high threshold to be deductible at all.<sup>235</sup>

Furthermore, when making this calculation, a taxpayer may include only those medical expenses that are “not compensated for by insurance or otherwise.”<sup>236</sup> This logical rule has particular significance for older Americans, because almost all people who are age sixty-five years and older have health insurance via the federal government’s Medicare program.<sup>237</sup> And almost 90% of this cohort also have some sort of supplemental coverage, be it “medigap” insurance, retiree health benefits from a former employer, health maintenance organization membership, or Medicaid benefits for elders who meet certain criteria regarding financial resources.<sup>238</sup> Although these various coverages do not cover all of the expenses that long-term care entails, they do cover the vast majority of hospital charges, doctors’ fees, and often a significant part of outpatient prescription drug costs as well.<sup>239</sup> Thus, most long-term care expenses face the percent-of-AGI limitation with only a minimal assist from other typical medical expenses. As a result, it is often quite difficult to meet the required threshold for tax deductibility, except when medical expenses are particularly onerous.

### 3. Qualifying Medical Expenses

The final barrier that is presented by the medical expense deduction is the definition in section 213(d)(1) of “medical care.” In the specific context of family caregiving, two types of expenditures are pertinent: “qualified long-term care services,” which are specifically

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<sup>234</sup> AGI of \$52,000 x 7.5% = \$3,900. Medical expenses of \$4,000 - \$3,900 floor = \$100 deduction.

<sup>235</sup> On the other hand, the medical expense deduction is not subject to the overall 3%-of-AGI limit that applies to upper-income taxpayers. See I.R.C. § 68(a)(1), (c)(1).

<sup>236</sup> I.R.C. § 213(a).

<sup>237</sup> See FROLIK & KAPLAN, *supra* note 116, at 58–60.

<sup>238</sup> See Thomas Rice & Jill Bernstein, *Supplemental Health Insurance for Medicare Beneficiaries*, MEDICARE BRIEF (Nat’l Acad. of Soc. Ins., Washington, D.C.), Nov. 1999, at 1, available at [http://www.nasi.org/usr\\_doc/medicare\\_brief\\_6.pdf](http://www.nasi.org/usr_doc/medicare_brief_6.pdf); see also Nadereh Pourat et al., *Socioeconomic Differences in Medicare Supplemental Coverage*, HEALTH AFF., Sept.–Oct. 2000, at 186, 188.

<sup>239</sup> See FROLIK & KAPLAN, *supra* note 116, at 67–68, 75–81, 93–95, 97–98. As to prescription drug coverage, see generally Richard L. Kaplan, *The Medicare Drug Benefit: A Prescription for Confusion*, 1 NAELA J. 167 (2005).

included in the statute's definition of "medical care,"<sup>240</sup> and various residential outlays that are made to accommodate an aging family member. Both types of costs will now be considered.

*a. Long-Term Care Services*

The statute's inclusion of "qualified long-term care services" references the definition of those services in Code section 7702B(c). That section defines these services as "necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and *maintenance or personal care services*."<sup>241</sup> Although there is considerable overlap in the components of this expansive definition, most of what family providers of elder care typically do is best covered in the phrase that is italicized. That phrase, in turn, is defined as "any care the primary purpose of which is the provision of needed assistance with any of the disabilities as a result of which the individual is a *chronically ill individual*."<sup>242</sup>

This rather cryptic definition clearly hinges on the presence of a "chronically ill individual," which is a key term of art in this area. This term is defined as follows:

The term "chronically ill individual" means any individual who has been certified by a licensed health care practitioner as:

- (i) being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity, . . . or
- (iii) requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment.<sup>243</sup>

In applying this definition, there are three key features. First, the referenced "activities of daily living" include the following: eating, toileting, transferring (i.e., moving from a bed to a chair), bathing, dressing, and continence.<sup>244</sup> Second, the person in question must be certified as requiring assistance with these activities by a "licensed

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<sup>240</sup> I.R.C. § 213(d)(1)(C).

<sup>241</sup> *Id.* § 7702B(c)(1) (emphasis added).

<sup>242</sup> *Id.* § 7702B(c)(3) (emphasis added).

<sup>243</sup> *Id.* § 7702B(c)(2)(A).

<sup>244</sup> *Id.* § 7702B(c)(2)(B).

health care practitioner,”<sup>245</sup> which includes “any physician . . . and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary.”<sup>246</sup> Third, this certification must be done every year.<sup>247</sup>

If these requirements are met, the services that are provided are “qualified long-term care services,” and any expense that is paid for those services qualifies as a deductible medical expense. Most family caregivers, however, do not charge their relatives for the services that they provide, so there is no expense associated with their labors that can serve as the basis of a tax deduction. Moreover, even if the family caregiver decided to charge her older relative at regular market rates, section 213(d)(11)(A) indicates that payments for “qualified long-term care services” are not deductible if the person who was paid is the spouse or any relative of the person who is receiving the care in question.<sup>248</sup> For this purpose, the term “relative” is extraordinarily expansive, encompassing all seven categories of relationships in the tax code’s definition of possible dependents,<sup>249</sup> as well as any partnership or corporation that is related to the person who is receiving the long-term care services.<sup>250</sup> The standard related-party rules of sections 267(b) and 707(b) are utilized in determining the relatedness of partnerships and corporations.<sup>251</sup>

There is an exception, however, if the family caregiver is a “licensed professional with respect to such service,”<sup>252</sup> in which case the payments will count as a medical expense. Some family providers of elder care are so licensed and may have worked for other people in this capacity before they started caring for their aging relative. Some caregivers, in fact, continue to work for others and also provide care for their relative when they are “off duty.” In these circumstances, payments to these family caregivers would be eligible for deduction as medical expenses. But most family caregivers do not have the requisite professional credentials, and the informal care that they provide usually does not necessitate that level of training. Accordingly, any payments that they might receive will not be

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<sup>245</sup> *Id.* § 7702B(c)(2)(A).

<sup>246</sup> *Id.* § 7702B(c)(4).

<sup>247</sup> *Id.* § 7702B(c)(2)(A).

<sup>248</sup> *Id.* § 213(d)(11)(A).

<sup>249</sup> *Id.* §§ 213(d)(11) (penultimate sentence), 152(d)(2)(A)–(G).

<sup>250</sup> *Id.* § 213(d)(11)(B).

<sup>251</sup> See generally BITTKER ET AL., *supra* note 114, ¶ 16.06[2][b]; 1 WILLIAM S. MCKEE ET AL., *FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS* ¶ 13.04 (3d ed. 2004).

<sup>252</sup> I.R.C. § 213(d)(11)(A).

deductible as medical expenses.

On the other hand, many family providers of elder care engage licensed professionals to provide some home care, either to care for their relatives when they are at work, or to supplement the nontechnical care that they provide. In addition, many family caregivers need a respite from their never-ending responsibilities or perhaps even a vacation. Payments by family caregivers to such professionals would be deductible as medical expense, as long as they “are provided pursuant to a plan of care prescribed by a licensed health care practitioner.”<sup>253</sup> For some family caregivers, such payments might represent a significant tax deduction. Payments that they receive themselves, however, usually do not provide an income tax benefit.

*b. Accommodating Expenditures*

When a family caregiver moves into an older relative’s home or moves that relative into the caregiver’s home, certain physical changes to the residential environment are often required to accommodate the new living arrangement. Many, if not most, of these changes are permanent improvements to the physical residence. The question for present purposes is whether, and to what extent, these expenditures are deductible as medical expenses.

Although section 213 has no specific provision on point, the regulations under this section have long allowed medical expense deductions for part of the cost of such physically accommodating changes. In pertinent part, they provide as follows:

[A] capital expenditure made by the taxpayer may qualify as a medical expense, if it has as its primary purpose the medical care . . . of the taxpayer, his spouse, or his dependent. . . . [A] capital expenditure for permanent improvement or betterment of property which would not ordinarily be for the purpose of medical care . . . may, nevertheless, qualify as a medical expense *to the extent that the expenditure exceeds the increase in the value of the related property*, if the particular expenditure is related directly to medical care.<sup>254</sup>

The regulations then describe a situation in which a physician advised the taxpayer to install an elevator in his home to accommodate his

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<sup>253</sup> *Id.* § 7702B(c)(1)(B).

<sup>254</sup> Treas. Reg. § 1.213-1(e)(1)(iii) (as amended in 1979) (emphasis added).

wife's heart condition. The regulations further hypothesize that the elevator cost \$1,000 (this is an *old* regulation!), and the home increased in value by \$700. Accordingly, the \$300 difference was categorized as a deductible medical expense.<sup>255</sup> And if the home's value had not increased at all, the entire cost of the elevator would have been a qualifying medical expense.<sup>256</sup> Finally, the regulations note that expenses "for the operation or maintenance of a capital asset" qualify as medical expenses "if they have as their primary purpose the medical care" of the affected individual.<sup>257</sup>

Applying these principles to any given fact situation will involve issues of medical necessity, especially if a doctor did not actually prescribe the expenditures, as well as factual questions about the pre- and post-installation valuation of the residence in question. The Internal Revenue Service has challenged a number of taxpayers regarding the medical necessity of expenditures for in-ground swimming pools,<sup>258</sup> particularly those with luxurious features,<sup>259</sup> but otherwise the Service has been willing to accept as medically necessary a wide range of residential accommodations. In Revenue Ruling 87-106, it provided the following nonexhaustive list of capital expenditures as possibly qualifying medical expenditures:

1. constructing entrance or exit ramps to the residence;
2. widening doorways at entrances or exits to the residence;
3. widening or otherwise modifying hallways and interior doorways;
4. installing railing, support bars, or other modifications to bathrooms;
5. lowering of or making other modifications to kitchen cabinets and equipment;
6. altering the location of or otherwise modifying electrical outlets and fixtures;
7. installing porch lifts and other forms of lifts [other than

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<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> *See, e.g.,* *Evanoff v. Commissioner*, 44 T.C.M. (CCH) 1394 (1982) (stating that no deduction is available where year-round swimming facilities were available); *Robbins v. Commissioner*, 44 T.C.M. (CCH) 1254 (1982) (stating that no part of the purchase price of a home with a swimming pool can be deducted).

<sup>259</sup> *See Ferris v. Commissioner*, 582 F.2d 1112 (7th Cir. 1978) (pool constructed of hand-cut, hand-laid stone costing \$195,000 in 1971).

- elevators];
8. modifying fire alarms, smoke detectors, and other warning systems;
  9. modifying stairs;
  10. adding handrails or grab bars whether or not in bathrooms;
  11. modifying hardware on doors;
  12. modifying areas in front of entrance and exit doorways; and
  13. grading of ground to provide access to the residence.<sup>260</sup>

Thus, as long as family providers of elder care can document the medical necessity of their efforts to accommodate their older relative and the *net* cost after installation of these efforts, many of these expenditures should qualify as deductible medical expenses under section 213.

#### 4. Summary

The tax benefit of the medical expense deduction for family providers of elder care is uncertain and often illusory. Outright payments to family members are usually not counted, though permanent improvements to a caregiver's residence that are needed to accommodate an older relative will generally qualify, at least in part. Even then, however, the deductible portion is limited to the excess of such amounts over 7.5% of the caregiver's AGI and can be claimed only as an itemized deduction. As a result of these restrictions, few family caregivers can confidently anticipate significant tax savings, especially for ongoing expenses versus one-time capital expenditures.

### V. LEGISLATIVE PROPOSALS FOR FAMILY-PROVIDED CARE

As the preceding Part has shown, the U.S. tax system offers precious little support for family members who care for older relatives.<sup>261</sup> However, a number of proposals have been made in

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<sup>260</sup> Rev. Rul. 87-106, 1987-2 C.B. 67.

<sup>261</sup> Even the tax code's credit for "dependent care services" is extremely constricted. See I.R.C. § 21. This credit is based on qualifying expenses only if they "are incurred to enable the taxpayer to be gainfully employed." *Id.* § 21(b)(2)(A). Thus, a caregiver who does not receive earned income receives no tax credit at all. Moreover, even an employed caregiver must be providing care for a "dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself."

recent years to provide some federal tax relief to people who are in this situation. These proposals are the focus of this Part.

The Bush Administration included a provision in its fiscal year 2003 budget that was eventually adopted by the U.S. House of Representatives on July 25, 2002,<sup>262</sup> but was never enacted. This provision would have created an additional exemption for family members who care for someone in their household who has “long-term care needs.”<sup>263</sup> Such a person would need to meet the standards for being a dependent,<sup>264</sup> as examined in the preceding Part, and this person must require assistance with at least two of the “activities of daily living” that are enumerated in section 7702B(c),<sup>265</sup> also explained in the preceding Part of this Article. The amount of this additional exemption would be \$500 initially, and would then increase over a ten-year period to the amount of the personal exemption.<sup>266</sup> Like all tax deductions, the actual value of this additional exemption would vary with the taxable position of the taxpayer who is claiming it. This value could be as low as zero or as high as 35% of the exemption amount, as explained earlier.<sup>267</sup> The only way to avoid this predicament, of course, is to provide a tax *credit* instead of a deduction,<sup>268</sup> and that approach is taken by the other proposals that will be analyzed here. Tax credits that are tied to specified amounts will be considered first, and then tax credits that are tied to actual incurred expenses will be examined.

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*Id.* § 21(b)(1)(B) (emphasis added). Thus, if the older adult does not qualify as the taxpayer’s dependent per the tests described in Part IV.A. of this Article, no tax credit is allowed. Finally, the credit is calculated as a declining percentage based on the caregiver’s income, such that the maximum credit for someone with an AGI of more than \$43,000 is only \$600. *See id.* § 21(a)(2), (c)(1) (20% of \$3,000 = \$600).

<sup>262</sup> H.R. 4946, 107th Cong. (2002); *see* Edwin Park, *House Passes Health Tax Package That Provides Little Assistance to People with Long-Term Care Needs* (Ctr. on Budget & Policy Priorities, Washington, D.C.), Aug. 16, 2002, at 1, *available at* <http://www.cbpp.org/8-16-02health.pdf>.

<sup>263</sup> H.R. 4946, 107th Cong. § 3(a) (2002).

<sup>264</sup> *Id.* *See supra* Part IV.A.1–2 (discussing standards for qualifying as a dependent).

<sup>265</sup> H.R. 4946, 107th Cong. § 3(a) (2002); *see supra* Part IV.B.3.a (discussing section 7702B(c) requirements).

<sup>266</sup> H.R. 4946, 107th Cong. § 3(a) (2002).

<sup>267</sup> *See supra* Part IV.A.

<sup>268</sup> *See* STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 108 (1985).

*A. Specified-Amount Care Credits*

In 2003, Senator Evan Bayh of Indiana introduced Senate Bill 1031, which offers a tax credit of \$3,000 to the “eligible caregiver” of an “applicable individual.”<sup>269</sup> Similar proposals were made in the House of Representatives that year<sup>270</sup> and the year following,<sup>271</sup> and many of the key definitions and parameters are the same. Moreover, many components of these proposals are modifications of the features that were examined in the preceding Part’s discussion of the current tax law provisions on personal exemptions and medical expense deductions.<sup>272</sup>

For example, Senate Bill 1031 requires that the person who needs care must qualify as the putative caregiver’s “dependent,” but it then liberalizes two of the tests for that status.<sup>273</sup> So, instead of the general dependency “support test,” an older relative must have “as his principal place of abode the home of the taxpayer” and must be “a member of the taxpayer’s household for over half of the taxable year.”<sup>274</sup> And if more than one person qualifies as an “eligible caregiver,” the bill provides a mechanism that is very similar to existing “multiple support agreements,” whereby the caregivers may designate which specific caregiver will claim the tax credit via a “written declaration” that is filed with the government.<sup>275</sup> In any case, this residency test should be much easier to implement than the tax code’s general inquiry into what constitutes “support” and who provided the same.

Similarly, the “income test” is expanded from the general dependency context to the following formula: the exemption amount, plus the standard deduction, plus the additional standard deduction for a person who is at least sixty-five years old.<sup>276</sup> In 2005, for example, this amount would be \$9,450 (exemption amount of \$3,200, plus standard deduction of \$5,000, plus age sixty-five additional deduction of \$1,250).<sup>277</sup> Many senior citizens may still be rendered

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<sup>269</sup> S. 1031, 108th Cong. (2003).

<sup>270</sup> H.R. 2096, 108th Cong. (2003).

<sup>271</sup> H.R. 5110, 108th Cong. (2004).

<sup>272</sup> *See supra* Part IV.

<sup>273</sup> S. 1031, 108th Cong. § 1(b) (2003).

<sup>274</sup> *Id.*

<sup>275</sup> *Id.* If no agreement is in place, the exemption may be claimed by the caregiver with the highest income. *Id.*

<sup>276</sup> *Id.*

<sup>277</sup> Rev. Proc. 2004-71, §§ 3.10(1), 3.10(3), 3.17(1), 2004-50 I.R.B. 970, 973–74.

ineligible by this standard, but the increased income threshold should expand the number of individuals who can qualify as an “applicable individual.”

In addition to the new residency test and the expanded income test, an “applicable individual” must be certified by a physician as having “long-term care needs” for a period of “at least 180 consecutive days.”<sup>278</sup> Unlike the provision that was examined earlier in connection with the medical expense deduction,<sup>279</sup> this certification can be made *only* by a physician, rather than by a registered nurse or a licensed social worker.<sup>280</sup> Moreover, the medical standard in question is similar but slightly different; i.e., a person with “long-term care needs” is someone who:

(I) is unable to perform (without substantial assistance from another individual) at least 3 activities of daily living (as defined in section 7702B(c)(2)(B)) due to a loss of functional capacity, or

(II) requires substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment and is unable to perform at least 1 activity of daily living (as so defined).<sup>281</sup>

This certification, it should be noted, must be made within the 39 1/2-month period that ends with the due date for filing the tax return (ignoring any extensions) on which the “family care credit” is being claimed.<sup>282</sup> Finally, this bill requires the caregiver to include the “taxpayer identification number” of both the “applicable individual” who is receiving family-provided elder care and the physician who certified that person’s medical eligibility under the standard that was set forth above.<sup>283</sup>

The House version of this proposal, House Bill 2096,<sup>284</sup> was introduced within a week of Senate Bill 1031’s introduction and is basically identical to the latter’s provisions regarding the family care credit, with two fiscally oriented exceptions. First, House Bill 2096

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<sup>278</sup> S. 1031, 108th Cong. § 1(b) (2003).

<sup>279</sup> See discussion of code section 7702B(c)(4), *supra* Part IV.B.3.a.

<sup>280</sup> S. 1031, 108th Cong. § 1(b) (2003).

<sup>281</sup> *Id.*

<sup>282</sup> *Id.*

<sup>283</sup> *Id.* § 1(c).

<sup>284</sup> H.R. 2096, 108th Cong. (2003).

provides that the tax credit is initially only \$1,000, and then increases by \$500 per year until it reaches the same \$3,000 level<sup>285</sup> that Senate Bill 1031 provides at the outset.<sup>286</sup> Second, House Bill 2096 has one of those annoying income-based phase-out mechanisms, whereby a taxpayer loses \$100 of the credit for each \$1,000 (or fraction thereof) of “modified adjusted gross income” over certain specified thresholds.<sup>287</sup> Those thresholds are \$150,000 for married persons who file joint tax returns and \$75,000 for everyone else, and both thresholds are to be indexed for inflation.<sup>288</sup>

Despite their ubiquity, such income-based phase-outs increase tax compliance difficulties and surreptitiously raise marginal effective tax rates. But they also lower a proposal’s projected revenue cost and thereby increase the likelihood that the proposal will ultimately be enacted. As such, they are probably inevitable even if undesirable on general tax policy grounds. Indeed, when another bill was introduced one year later with the grandiloquent title of the “Comprehensive Long-Term Care Support Act of 2004,”<sup>289</sup> it included both the tax credit phase-in schedule of House Bill 2096 and its income-based phase-out mechanism.<sup>290</sup>

### *B. Expense-Based Care Credits*

On June 9, 2003, a group of eleven Democratic Senators, including 2008 Presidential hopeful Senator Hillary Rodham Clinton and Senator Edward Kennedy, introduced the “Family Caregiver Relief Act of 2003.”<sup>291</sup> Unlike the proposals that were analyzed above,<sup>292</sup> this bill bases its tax credit on the actual out-of-pocket expenses that a caregiver makes in connection with caring for an older relative.<sup>293</sup> Those expenses are limited by a global cap of \$5,000<sup>294</sup> and

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<sup>285</sup> *Id.* § 3(a).

<sup>286</sup> S. 1031, 108th Cong. § 1(a)(1) (2003).

<sup>287</sup> H.R. 2096, 108th Cong. § 3(a) (2003).

<sup>288</sup> *Id.*

<sup>289</sup> H.R. 5110, 108th Cong. (2004).

<sup>290</sup> *Id.* § 4(a). Virtually identical legislation was introduced in 2005. *See* S. 1602, 109th Cong. § 122(a) (2005); S. 1244, 109th Cong. § 3(a) (2005); H.R. 2682, 109th Cong. § 3(a) (2005); *see also* H.R. 2935, 109th Cong. § 3(a) (2005) (specifying a credit of \$4,000 per individual for whom the taxpayer is an eligible caregiver).

<sup>291</sup> S. 1214, 108th Cong. (2003).

<sup>292</sup> *See supra* Part V.A.

<sup>293</sup> S. 1214, 108th Cong. § 2(a)(1) (2003).

<sup>294</sup> *Id.* § 2(a)(2).

must fit into one of six specified categories of “eligible expenses.”<sup>295</sup> The first two such categories are already in the tax law — namely, “medical care (as defined in section 213(d)(1) . . . )”<sup>296</sup> and “lodging away from home in accordance with section 213(d)(2).”<sup>297</sup> The first of these categories was already examined in the specific context of elder care in the preceding Part of this Article.<sup>298</sup> As to the second category, lodging expenses are defined in the referenced subparagraph as amounts that are paid “primarily for and essential to medical care.”<sup>299</sup> These amounts may not be “lavish or extravagant under the circumstances,”<sup>300</sup> and the medical care in question must be “provided by a physician in a licensed hospital” or an equivalent facility.<sup>301</sup> Furthermore, there can be “no significant element of personal pleasure, recreation, or vacation in the travel away from home.”<sup>302</sup> Finally, the expense in question cannot exceed \$50 per night,<sup>303</sup> a threshold that is not indexed for inflation.

In any case, the real impact of this bill is in the three new categories of “eligible expenses.” The first such category is “adult day care,” which means “care provided for adults with functional or cognitive impairments through a structured, community-based group program which provides health, social, and other related support services on a less than 24-hour per day basis.”<sup>304</sup> The second new category is “custodial care,” which means “reasonable personal care services provided to assist with daily living and which do not require the skills of qualified technical or professional personnel.”<sup>305</sup> And the third new category is “respite care,” which includes “planned or emergency care provided to an applicable individual in order to provide temporary relief to an eligible caregiver.”<sup>306</sup>

This bill is otherwise very similar to Senate Bill 1031, which was analyzed previously.<sup>307</sup> It uses the same definition of an “applicable

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<sup>295</sup> *Id.* § 2(b)(1).

<sup>296</sup> *Id.*

<sup>297</sup> *Id.*

<sup>298</sup> *See supra* Part IV.B.3.

<sup>299</sup> I.R.C. § 213(d)(2).

<sup>300</sup> *Id.*

<sup>301</sup> *Id.* § 213(d)(2)(A).

<sup>302</sup> *Id.* § 213(d)(2)(B).

<sup>303</sup> *Id.* § 213(d)(2) (last sentence).

<sup>304</sup> S. 1214, 108th Cong. § 2(b)(1) (2003).

<sup>305</sup> *Id.*

<sup>306</sup> *Id.*

<sup>307</sup> *See supra* Part V.A.

individual,” including the residency test instead of the general dependency “support test,” plus the expanded “income test.”<sup>308</sup> It also utilizes the same medical criteria, including an identical definition of “long-term care needs,”<sup>309</sup> and the same requirements of timely certification of such needs by a physician.<sup>310</sup> Even the “taxpayer identification number” requirements are the same respecting the “applicable individual” and the certifying physician.<sup>311</sup> The only difference in medical eligibility is the addition of an alternative test — namely, a person with “5 or more chronic conditions . . . [who] is unable to perform (without substantial assistance from another individual) at least 1 activity of daily living (as so defined) due to a loss of functional capacity.”<sup>312</sup> With “chronic condition” being defined as something “that lasts for at least 6 consecutive months and requires ongoing medical care,”<sup>313</sup> it is difficult to imagine someone who would be described in this category who would not already be considered an “applicable individual” under the definition in the other proposal.<sup>314</sup> In other words, the main difference in this approach is that actual expenses must be documented rather than using a stipulated amount. As a result, the allowable tax credit could be higher in this bill, but otherwise, it is essentially the same as Senate Bill 1031.

A somewhat different tack was taken on April 18, 2005, when two Republican Senators introduced Senate Bill 835,<sup>315</sup> which they dubbed the SECURE Act. “SECURE” purports to be an acronym for “Senior Elder Care Relief and Empowerment,” even though the letter *U* is not present.<sup>316</sup> More importantly, this legislation also requires the caregiver to document actual “qualified elder care expenses” to obtain a tax credit.<sup>317</sup> These expenses include “qualified long-term care services,”<sup>318</sup> as defined in the medical expense deduction area that was examined in the preceding Part of this Article.<sup>319</sup> Also included are

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<sup>308</sup> S. 1214, 108th Cong. § 2(c) (2003).

<sup>309</sup> *Id.*

<sup>310</sup> *Id.*

<sup>311</sup> *Id.* § 2(d).

<sup>312</sup> *Id.* § 2(c).

<sup>313</sup> *Id.*

<sup>314</sup> *See* S. 1031, 108th Cong. § 1(b) (2003).

<sup>315</sup> S. 835, 109th Cong. (2005).

<sup>316</sup> *Id.* § 1.

<sup>317</sup> *Id.* § 2(a).

<sup>318</sup> *Id.*

<sup>319</sup> *See supra* Part IV.B.3.a.

“adult day care” and “respite care” expenses,<sup>320</sup> with both categories being defined in essentially the same way as in the Democratic Senators’ version.<sup>321</sup> This bill, however, does not count any “expense paid to a nursing facility,”<sup>322</sup> even though many such facilities provide short-term respite care as part of the portfolio of services that they offer.

Moreover, Senate Bill 835 uses a three-part standard for the older relative who is receiving family-provided elder care — or “qualified senior citizen” in its argot.<sup>323</sup> First, this person must be someone “who has attained normal retirement age” according to Social Security before the end of the taxable year.<sup>324</sup> “Normal retirement age” under this standard is a moving target that depends upon a person’s year of birth.<sup>325</sup> Thus, for persons who were born before 1938, that age is sixty-five years, but for persons who were born between 1938 and 1942, this age increases by two months each year.<sup>326</sup> And persons who were born from 1943 through 1954 have a “normal retirement age” of sixty-six years.<sup>327</sup> The second requirement is that the person who is receiving care must be a “chronically ill individual”<sup>328</sup> according to the same definition in section 7702B(c)(2)(B) that was examined in the preceding Part of this Article.<sup>329</sup>

The third requirement is that this person must be either a “dependent” or a “family member” of the taxpayer.<sup>330</sup> The term “dependent” here has the familiar definition that is found in section 152, but without any special modifications.<sup>331</sup> More curiously, the phrase “family member” is defined with reference to section 529(e)(2),<sup>332</sup> which deals with college savings plans.<sup>333</sup> That definition

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<sup>320</sup> S. 835, 109th Cong. § 2(a) (2005).

<sup>321</sup> See S. 1214, 108th Cong. § 2(b)(1) (2003).

<sup>322</sup> S. 835, 109th Cong. § 2(a) (2005).

<sup>323</sup> *Id.*

<sup>324</sup> *Id.*

<sup>325</sup> 42 U.S.C. § 416(l)(1) (2005).

<sup>326</sup> See FROLIK & KAPLAN, *supra* note 116, at 282.

<sup>327</sup> *Id.* This age increases gradually and reaches sixty-seven years for persons who are born after 1959. *Id.*

<sup>328</sup> S. 835, 109th Cong. § 2(a) (2005).

<sup>329</sup> See *supra* Part IV.B.3.a.

<sup>330</sup> S. 835, 109th Cong. § 2(a) (2005).

<sup>331</sup> *Id.*

<sup>332</sup> *Id.*

<sup>333</sup> See generally Richard L. Kaplan, *Funding a Grandchild’s College Education*, J. RETIREMENT PLAN., Sept.-Oct. 2001, at 15, 20–22.

encompasses a taxpayer's spouse,<sup>334</sup> any of the seven familial relationships in section 152(d) that qualify for possible "dependent" status,<sup>335</sup> and the spouse of anyone who is listed in one of these seven categories.<sup>336</sup> In addition, first cousins are included in this definition.<sup>337</sup> It is not clear whether additional care recipients would be covered by this bill but not by the other bills that were considered previously.

Notwithstanding these different definitional formulations, the really significant aspect of Senate Bill 835 is its calculation of the elder care tax credit. This bill allows a tax credit of 50% of the "qualified elder care expenses" in excess of \$1,000 per "qualified senior citizen."<sup>338</sup> Thus, if Bruce spent \$35,000 on eligible expenses to enable his mother-in-law to live in his home, this cost would be reduced by the bill's \$1,000 floor to \$34,000, and Bruce's tax credit would then be half of this amount, or \$17,000. As written, Senate Bill 835 has no upper limit on eligible expenses and no income-based phase-out on the tax credit itself. As a consequence, this proposal may present the largest federal revenue loss of the various bills that have been analyzed in this Part, but it also promises to provide the greatest tax relief to families who are providing care for their older relatives. Additional restrictions are typically incorporated as a tax proposal works its way through the legislative process, but the so-called SECURE Act at least *begins* with the most attractive package of elder care tax benefits.

## VI. CONCLUSION

Caring for an aging relative is a major phenomenon in the United States and will only increase further as America ages. One of the bills that was analyzed in the preceding Part included the following finding: "Since the late 1980s the proportion of households in the United States involved in unpaid caregiving activities jumped to over 25 percent."<sup>339</sup> Such activities represent serious work and merit serious recognition from government. Beyond the inherent psychic and emotional satisfaction that family provision of elder care can bring, some sort of financial reward is also appropriate.

Perhaps the most appropriate course of action would be for the

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<sup>334</sup> I.R.C. § 529(e)(2)(A).

<sup>335</sup> *Id.* § 529(e)(2)(B).

<sup>336</sup> *Id.* § 529(e)(2)(C).

<sup>337</sup> *Id.* § 529(e)(2)(D).

<sup>338</sup> S. 835, 109th Cong. § 2(a) (2005).

<sup>339</sup> H.R. 5110, 108th Cong. § 2(3) (2004).

Medicare program to actually pay family caregivers for the elder care services that they provide at regular market rates. Indeed, a bill that was entitled the “Family Caregiver Security Act of 2005” would do just that.<sup>340</sup> This legislation would also allow Medicare-approved home health care agencies to “provide for appropriate training and oversight of such services by a registered nurse”<sup>341</sup> and to provide family caregivers “with educational information and resources related to family caregiver health and wellness.”<sup>342</sup> Persons eligible for these benefits would include any family caregiver “who demonstrates proficiency in the provision of the home health aide services or *personal care assistant services* involved to the satisfaction of the supervising registered professional nurse.”<sup>343</sup> Suffice it to say that this proposal has no realistic chance of being enacted in the current political environment. Whatever expansion of Medicare was likely to occur has already manifested itself in the prescription drug benefit that was enacted in late 2003.<sup>344</sup>

Accordingly, family caregivers probably need to look to the tax code for any “second best” response to their situation.<sup>345</sup> As this

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<sup>340</sup> H.R. 175, 109th Cong. § 2(a) (2005). Such an approach is followed in Germany and the Netherlands. See JOSHUA M. WIENER ET AL., AARP PUB. POLICY INST., CONSUMER-DIRECTED HOME CARE IN THE NETHERLANDS, ENGLAND, AND GERMANY 13, 15 (2003), available at [http://assets.aarp.org/rgcenter/health/2003\\_12\\_eu\\_cd.pdf](http://assets.aarp.org/rgcenter/health/2003_12_eu_cd.pdf). A modified version applies in the United States for disabled veterans. See KAREN TRITZ, CONG. RESEARCH SERV., LONG-TERM CARE: CONSUMER-DIRECTED SERVICES UNDER MEDICAID 4 (2005), available at <http://www.law.umaryland.edu/marshall/crsreports/crsdocuments/RL322191212005.pdf>. In addition, many states operate Medicaid programs that use public funds to pay caregivers who are family members and friends. Spouses are generally not eligible, however, for such compensation and adult children often are not either. See NAT'L ASS'N OF STATE UNITS ON AGING & NAT'L COUNCIL ON AGING, STATES' EXPERIENCES IMPLEMENTING CONSUMER-DIRECTED HOME & COMMUNITY SERVICES 27–28 (2004), available at [http://www.nasua.org/pdf/20026\\_text.pdf](http://www.nasua.org/pdf/20026_text.pdf). As to the generally positive impact that such arrangements can have on family relationships and the quality of care provided, see Suzanne R. Kunkel et al., *For Love and Money: Paying Family Caregivers*, GENERATIONS, Winter 2003–04, at 74.

<sup>341</sup> H.R. 175, 109th Cong. § 2(a) (2005).

<sup>342</sup> *Id.*

<sup>343</sup> *Id.* (emphasis added).

<sup>344</sup> See Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, 117 Stat. 2066.

<sup>345</sup> An alternative approach allows family caregivers to make a claim against the estate of their care recipient for the value of the services that they provided. Illinois law authorizes such claims but most states do not. See 755 ILL. COMP. STAT. ANN. 5/18-1.1 (West 2004). To qualify, a caregiver must live with the care recipient and dedicate him- or herself to that person's care. *Id.* The amount of compensation is “based upon

article has shown, however, the law currently is not very helpful. The classic Supreme Court decision in *Commissioner v. Duberstein*<sup>346</sup> showed that even an occasional rendering of helpful service, done without any expectation of financial reward, can result in taxable income. A family caregiver's situation is usually characterized by recurrent provision of services, and in most cases would not even present a close question under the current law. Seniors' attempts to provide financial benefits to their caregivers via tax-free gifts and inheritances succeed presently only because of lax enforcement in this area. Such inattention undoubtedly discourages conscientious taxpayers from documenting what is actually taking place in a formalized caregiver compensation agreement, except when there are extenuating circumstances such as obtaining Medicaid eligibility for nursing home expenses.

Similarly, the tax code's existing provisions for personal exemptions and medical expense deductions provide relief to only a limited extent and under fairly uncertain conditions. The personal exemption is a relatively small allowance whose value increases with the caregiver's income, but is at increased risk of being lost as income levels rise. In any case, its statutory requirements, especially the "income test," make its availability extremely problematic when the putative dependent is an older adult with anything beyond rather minimal levels of income. The medical expense deduction has its greatest possible application in the context of accommodating improvements to a personal residence, because long-term care services that are provided by family members are ignored in most circumstances. Outsourced elder care may count as medical expenses, but even then, the applicable 7.5%-of-AGI floor and the status of medical expenses as an "itemized deduction" reduce the probability of actually claiming, as well as the likely amount of, any tax benefit from those expenses.

Recent legislative proposals, however, offer some hope. Coming from bipartisan sources, they offer tax credits that are not dependent on caregivers' tax brackets for their value. Making such tax credits refundable for caregivers with low or nonexistent tax liability would enhance their value still further. Some of these proposals offer fixed

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the nature and extent of the [care recipient's] disability" and is determined by the court. *Id.* Of course, such claims have value only to the extent that there are assets in the estate of the care recipient. For a critical analysis of this statute, see Heather M. Fossen Forrest, Comment, *Loosening the Wrapper on the Sandwich Generation: Private Compensation for Family Caregivers*, 63 LA. L. REV. 381, 401-07 (2003).

<sup>346</sup> 363 U.S. 278 (1960).

amounts that are independent of actual out-of-pocket caregiving expenses. Others are tied to such outlays, which are often incurred to supplement the major portion of elder care that family members provide on a *gratis* basis. While particular variations would be more beneficial than others for specific family situations, any of these proposals would be a major improvement over the status quo. As Americans live longer and as the incidence of age-related disabilities increases, Congress should enact some tangible recognition of the high value that society properly attaches to family providers of elder care.