Tax benefits for parents of kids with LD: 2009 update

Parents of children with a severe learning disability may be eligible for valuable tax benefits. Read our annual update.

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If you have a child with a severe learning disability (LD), you may qualify for valuable tax benefits. If your child has AD/HD or other physical, mental or emotional impairments, you may also qualify for tax benefits. Because tax laws are complex and many tax preparers often do not have occasion to use these unique tax benefits, families are at risk of losing refunds worth thousands of dollars. It's likely that 15 to 30 percent of families with a disabled child have one or more unclaimed tax benefits.
This guide provides a summary of the most significant federal income tax benefits and should not be considered legal advice. Tax decisions should not be made simply on the basis of the information provided here. You are advised to print out this guide and give a copy to your tax advisor. You should also explore potential state income tax benefits, which are too numerous to review in this guide.

Internal Revenue Service (IRS) publications represent the most accessible form of guidance to the tax rules for the general public, and relevant IRS publications are cited for each of the tax benefits listed below. The IRS also issues interpretations of the code and regulations called revenue rulings. These interpretations are formal, binding policy statements. Tax professionals rely on revenue rulings in advising clients about tax liabilities and tax benefits. For example, Revenue Ruling 78-340, discussed later, authorizes a medical expense deduction for tuition or tutoring fees paid for a child with a severe learning disability who is attending a special school at the recommendation of the child's doctor.

Tax benefits: Deductions versus credits

It's important to distinguish between two categories of tax benefits. One category is a "deduction from taxable income" or simply a "deduction." The value of a deduction is based on the marginal tax rate of the taxpayer. If a person has a tax deduction worth $1,000, the actual value of the deduction will be determined by the taxpayer's tax rate. So a taxpayer in the lowest tax rate bracket, 10%, will have his taxable income reduced by $1,000 and save $100 (10% of $1,000). However, a taxpayer in a higher bracket, for example, 28%, will have his taxable income reduced by $1,000 and save $280 (28% of $1,000).

The second tax benefit is a tax credit, which is a dollar-for-dollar reduction in tax liability. An individual with a tax credit worth $1,000 will have his tax bill reduced by $1,000. This means that the actual amount of taxes is reduced by the amount of the tax credit. However, because tax laws and procedures are very complicated, other factors can influence the ultimate value to the taxpayer.

The following summarizes the principal tax benefits that may be available to families caring for children with severe learning disabilities.

Retroactive claims for refunds

The IRS allows taxpayers to file amended returns and collect refunds for unclaimed tax benefits retroactively up to three years. This means a taxpayer can file an amended return for the 2006 tax year (and also for the 2007 and 2008 tax years) and claim a refund if the return is filed not later than April 15, 2010 (See IRS Publication 17, "Your Federal Income Tax," 2009, pages 21-22).

Besides parents, who can claim a child as a dependent?

A relative caretaker (e.g., a grandparent or aunt) or a non-relative caretaker (e.g., a foster parent or legal guardian) may be able to claim a child as a dependent and qualify for related tax benefits. A relative caretaker and the child are not required to live in the same household. More information is available in IRS Publication 501, "Exemptions, Standard Deduction and Filing Information," pages 11-21(PDF).

Eligibility is determined by a five-part test. The most critical requirement is that the caretaker must provide more than half of overall financial support for the child. For example, there may be cases where the caretaker is making a substantial financial contribution toward LD-related expenses (e.g., private school tuition) that represents more than half of the overall cost of support for the child. In those situations, the caretaker could list the child as a dependent and claim the tuition as a medical expense deduction on Schedule A.

Medical expense deductions

A taxpayer may claim a deduction for medical expenses of the taxpayer or the taxpayer's dependents (see box for more information on dependents). Section 1.213-1(e)(1)(v)(a) of the Department of the Treasury regulations provides, in part, that while ordinary education is not medical care, the cost of medical care includes the cost of attending a special school for a mentally or physically handicapped individual, if his condition is such that the resources of the institution for alleviating such mental or physical handicap are a principal reason for his presence there. As such, the IRS has ruled that tuition and transportation costs for a special school that has a program designed to educate children with learning disabilities and amounts paid for a child's tutoring by a teacher specially trained and qualified to deal with severe learning disabilities may also be deducted. (Revenue Ruling 78-340, 1978-2 C.B. 124.) Special instruction, training or therapy, such as Braille, lipreading, sign language instruction, speech therapy and remedial reading instruction, would also be deductible. Related books and materials can qualify for the medical expense deduction. IRS Private Letter Ruling 8616069 (1985 PLR L 41) discusses what types of conditions and instruction may not qualify.

Generally, for families to qualify for the deduction, the child's doctor must recommend the special school, therapy or tutoring, and there must be a medical diagnosis of a neurological disorder, such as a severe learning disability, made by a medical professional. Examples of special schools include the following:

- Schools for teaching Braille or lip reading.
- A psychiatrically oriented boarding school recommended by a psychiatrist who diagnosed a taxpayer's child as suffering from a severe adjustment reaction of adolescence.
- Schools for training the mentally retarded.
- Schools for average and above average students who have learning disabilities, with the purpose of providing an environment in which they can adjust to a normal competitive classroom situation.
- A regular school's curriculum that was specially designed to meet the needs of handicapped children whose IQ scores ranged between 50 and 75.

The following are examples of institutions that were not special schools:

- A college preparatory school with the stated goal of educating the underachiever but with no services treating mental or emotional problems.

- An accredited boarding and day school for boys in the first through ninth grades that had a policy of accepting students needing special help. These students comprised approximately 12 to 15 percent of the student body. Although a taxpayer's son took advantage of the special learning center and the psychological counseling program, the school was not a special school because the ordinary services the child received were not incidental to the special services.
- A private school to which the taxpayer's doctor recommended he send his bright but somewhat learning disabled son. The school had no special program designed for students with learning disabilities, had no psychologists or psychiatrists on staff, did not hold itself out as a special school, had a student body comparable to that of regular schools, and provided no medical services to students.
- A nursery school and summer camp recommended by a doctor for a taxpayer's children with speech disorders to promote proper speech development through contact with normal speaking children.

Transportation expenses for the special school or the tutor also qualify for a medical expense deduction. If transportation is by car, the allowable expense for tax year 2009 is 24 cents per mile or the actual cost of operating the vehicle.
Furthermore, deductible medical expenses include expenses for the diagnosis and treatment of physical disorders, and travel and lodging costs related to such diagnosis and treatment expenses. This can include testing by a speech-language pathologist, psychologist, neurologist or other person with professional qualifications.

Note: Expenses claimed as a medical expense deduction and later reimbursed by an insurance company or school district (e.g., the service is adopted as part of the child's Individualized Education Program, or IEP) must be reported as taxable income for the year in which the reimbursements are received. If parents have paid for the services but haven't claimed them as a medical expense, they should ask that the school district not issue a 1099 form in connection with the reimbursement. If the school district does issue a 1099, consult with a tax advisor about how to proceed.

Not everyone who has medical expenses can use them on their tax return. Medical expenses must be claimed on Schedule A, Itemized Deductions, and are subject to certain limitations. First, the family must have itemized deductions that exceed their standard deduction in order to use Schedule A (about 65% of taxpayers do not itemize for this reason). Second, medical expenses are allowed as a deduction only to the extent that they exceed 7.5% of adjusted gross income, a significant threshold for many families (See IRS Publication 502, "Medical and Dental Expenses," page 3).

What expenses qualify for a tax deduction?

The following expenses may qualify for the deduction if a medical professional recommends the service or treatment for the child and there is a medical diagnosis of a neurological disorder, such as a severe learning disability:

- Tuition for a private school
- Tutoring
- Specialized materials (e.g., books, software and instructional materials)
- Diagnostic evaluations (by a private practitioner)
- Therapy

- Transportation expenses for a private school or tutor

Health savings accounts and flexible savings arrangements

Alternative approaches to obtaining tax benefits in connection with medical expenses may involve use of a health savings account (HSA) or a flexible savings arrangement (FSA). All the LD-related medical expenses reviewed above can be paid through an HSA or FSA with pretax dollars. An HSA allows a worker to use up to $5,950 for family coverage (catch up contribution for individuals who are 55 or older is increased by statute to $1,000 per qualifying spouse for 2009 and all years going forward) in pretax income for medical expenses. An HSA may only be opened when the employee has a "high deductible" health insurance plan. Amounts placed in an HSA may be carried over to following years if not used. An FSA can be part of a "cafeteria plan" of alternative fringe benefits offered by an employer. An employee can allocate pretax income to the account and then withdraw it during the year to pay for medical expenses. Employers may also make contributions to the FSA, and the maximum amount is set by the terms of the employer plan. Two important conditions are:

1. The amount to be placed in the account must be determined by the employee at the beginning of the year.
2. Funds in the FSA that are not used by the end of the year are lost. However, a recent amendment allows a onetime transfer of FSA funds to an HAS, but transfers must be made directly to the HSA before January 1, 2012.

The employer's human resources office can provide more information. Also, see IRS Publication 969, "Health Savings Accounts and Other Tax-Favored Health Plans."

Deduction for disability-related conferences

In May 2000 the IRS issued Revenue Ruling 2000-24, which offers guidance — and good news — for parents of children with disabilities. Parents who attend conferences to obtain medical information concerning treatment for and care of their child may deduct some of the costs of attending a medical conference related to a dependent's chronic health condition. The important points to remember are:

- Medical expenses are deductible only to the extent that they exceed 7.5% of an individual's adjusted gross income, and that limitation applies to this deduction as well.
- Costs of admission and transportation to a medical conference related to your dependent's chronic health condition are now deductible, if the costs are primarily for and essential to the care of the dependent.
- Costs of meals and lodging related to a conference, however, are not deductible. (Note, however, that lodging — up to $50 per night — is deductible if you must travel and stay at a hotel while your dependent is receiving medical treatment from a licensed physician in a hospital or a related or equivalent setting.)
- Costs are "primarily for and essential to the care of the dependent" (and therefore deductible) if:

1. The parent attends the conference upon the recommendation of a medical provider treating the child;
2. The conference disseminates medical information concerning the child's condition that may be useful in making decisions about the treatment or care of the child;
3. The primary purpose of the visit is to attend the conference. While at the conference, the parent's

social and recreational activities in the city he or she is visiting are secondary to attendance at the conference;

4. The conference deals with specific issues related to a medical condition and does not just relate to general health and well-being.

Child and Dependent Care Credit

The Child and Dependent Care Credit is allowed for work-related expenses incurred for dependents of the taxpayer. Generally the dependent must be under the age of 13. However, if the child has a disability and requires supervision, the age limit is waived. For example, a 16-year-old with severe AD/HD and a behavior disorder who cannot be left alone without adult supervision would be a qualifying child for this credit.

Expenses up to $3,000 per year for one qualifying dependent and up to $6,000 for two or more qualifying dependents are allowed. Expenses for regular child care services, after-school programs and summer camps qualify, although overnight summer camp expenses do not. Payments to a relative to care for a child also qualify, as long as the relative is not a dependent of the taxpayer. For 2009, the credit is calculated at 20% to 35% percent of allowable expenses, based on the family's adjusted gross income. The average credit is about $600 but can be as high as $2,100. (See IRS Publication 503, "Child and Dependent Care Expenses.")

Exemption for dependents

A taxpayer is entitled to claim an exemption for each qualified dependent. This may appear relatively straightforward, but caretakers, such as grandparents, aunts or even foster parents, may overlook exemptions. Also, in some cases following a divorce, a noncustodial parent who provides the majority of support for a child with a severe learning disability, and pays for medical/educational expenses related to the child's learning disability, may likewise qualify for both the exemption and medical expense deductions.

A new definition of "qualifying child" took effect in the 2005 tax year; the most significant change is that the taxpayer need not show support for a qualifying child, but the child must live with the taxpayer for more than six months. For each dependent, there is an exemption from taxable income, worth $3,650 for the 2009 tax year. For a taxpayer with a marginal tax rate of 28%, each exemption will reduce the tax liability by $1,022. Equally important, the dependency status is required for some tax benefits such as the child and dependent care credit listed above. Also, dependents under age 17 qualify for the Child Tax Credit, worth up to $1,000 per child. (See IRS Publication 501, "Exemptions, Standard Deduction and Filing Information," and "Instructions to Form 1040.")

Note: The gift tax — which for 2009 imposes a tax on the donor for gifts over $13,000 — generally doesn't apply to payments for medical expenses or education. This is a complex topic and should be discussed with a tax advisor when a taxpayer provides, or plans to provide, an amount greater that $13,000 to anyone not a dependent. For tax year 2010, the same $13,000 limit applies.

Earned Income Tax Credit

Families with at least one child filing a return as single or head of household with adjusted gross income under $35,463 ($40,463 for married taxpayers filing a joint return) may qualify for the Earned Income Tax Credit (EITC) based on the presence of one qualifying child in the taxpayer's home. Families with at least three children filing a return as single or head of household with adjusted gross income under $43,279 ($48,279 married filing jointly) may qualify with three or more qualifying children. For EITC purposes, a qualifying child is a biological child, adopted child, stepchild or foster child who resided with the taxpayer for more than six months during the calendar year and is under age 19 at the end of the year. A qualifying child is also a child ages 19 to 23 who is a full-time student for at least one semester. Finally, a severely disabled child is a qualifying child without regard to age, even into adulthood, as long as the child continues to live with his parent(s). Note that a qualifying child for

EITC does not have to meet the requirements for a dependency exemption. EITC benefits are as high as $5,657 for families with three or more qualifying children and $3,043 with one qualifying child. (See IRS Publication 596, "Earned Income Tax Credit," for more information.)

Where to get more information

The IRS provides free booklets that cover each of the topics listed above. The titles listed below may be ordered by calling the IRS toll-free number: (800) 829-3676. Generally, taxpayers may order up to three copies of any publication or form. The following booklets may be helpful:

- IRS Publication 17, "Your Federal Income Tax" (a comprehensive 300-plus-page guide)
- IRS Publication 501, "Exemptions, Standard Deduction and Filing Information"
- IRS Publication 502, "Medical and Dental Expenses"
- IRS Publication 503, "Child and Dependent Care Expenses"
- IRS Publication 596, "Earned Income Tax Credit"
- IRS Publication 969, "Health Savings Accounts and Other Tax-Favored Health Plans"

Extensive information can also be obtained from the IRS. The American Bar Association's Taxation Section contains links to scores of tax-related sites.

Tax counseling and tax-preparation assistance

Certified public accountants (CPAs) represent one source of tax advisors, although not all CPAs have expertise in this area. Enrolled agents are individuals licensed by the IRS to represent taxpayers, and this group generally has a high degree of expertise.

Typically, charges for a tax return with multiple deductions and credits will cost $150 to $400. Several national companies provide tax preparation and tax counseling services. Many operate only during the tax-filing season, but a small number in larger urban areas are open year-round. Fees charged by these companies are lower than the fees typically charged by CPAs and enrolled agents.

Some parents may not be able to afford fees charged by professional tax preparers, who generally seek payment in advance. An option for lower-income clients is the Volunteer Income Tax Assistance (VITA) program. However, because of the volunteers' broad range of skills and expertise, caution is recommended. Some large cities have one or more VITA programs that offer professional-level services. A university accounting department or the local legal services program may be able to help you identify a high-quality VITA program.

Disputes with the IRS

Disputes with the IRS are relatively rare; less than 1.5% of all individual income tax returns are subject to an IRS audit. However, if the IRS questions your return and you feel an IRS agent is not responding properly, contact the taxpayer advocate for assistance toll-free: (877) 777-4778. Low-income taxpayer clinics are another source of help. The IRS funds more than 100 clinics to represent lower-income taxpayers in disputes with the IRS or state revenue departments. Clinics assist taxpayers with income under 250% of the poverty level — about $50,000 for a family of four. Some clinics, especially those attached to law schools, will represent higher-income families. Information on the nearest clinic can be obtained from the general IRS toll-free inquiry number: (800) 829-1040. Families above this income level should call their county or state bar association.

Final thoughts

This guide offers a brief summary of some of the potential tax benefits that may be available to you. You should obtain copies of the IRS publications cited above and discuss with your tax advisor whether these benefits apply to you. Again, you should not rely on this guide alone to determine whether you should claim any of the tax benefits reviewed here.

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