Tax Benefits of Life Care Communities

by Bernadette O'Toole and Erin Eastlack

Many Baby Boomers leaving the workforce are faced with choosing between a myriad of retirement accommodations. A lot of retirees will choose to "age in place," meaning they'll remain in their principal residence. Others will move into senior housing communities for people 55 and older. This path offers several levels of options, from no care to "fee for service" (pay as you go) to residence in a continuing care retirement community (CCRC). The decision to move from the primary home is complex, because it requires thoughtful consideration of one's desires versus needs, such as social interaction, health care services, financial resources, and potential tax benefits.

A life care community is a retirement community that offers multiple levels of service and care, and typically includes independent living, assisted living, and skilled nursing. Many retirees don't realize that living in a life care community can provide tax benefits that equal or exceed those claimed in conjunction with ownership of a principal residence, primarily the deduction of mortgage interest and real estate tax deductions. Selecting a life care contract can provide a substantial "medical expense" deduction the year the contract is executed, as well as ongoing annual medical expense deductions, which are available for each year that the contract is in effect.

To obtain a life care contract, applicants are often required to undergo financial and medical screening, and in many situations must be able to live independently upon entering the community. To be eligible for the medical expense deduction, the individual must sign a residency contract (or life care contract) with a life care community.

An individual who enters into a life care contract will be entitled to receive benefits in the form of a medical expense deduction. IRS rulings have supported the deduction of a portion of the entrance fees, as well as the monthly service fees related to residence under a life care contract. Justification for the medical expense deduction is based on the community's obligation to provide care to its residents along with the cost for the community to provide that care. While a number of significant tax rulings have periodically revisited the methodology for this calculation, the basis for the deduction, in theory, has not been challenged.

The medical expense deduction has two components: 1) a one-time deduction when the entrance fee is paid and 2) an ongoing tax benefit in conjunction with the payment of monthly service fees. Both of these deductions are limited based on the "medical component" of costs identified by the community and may be further limited to deduction based on the adjusted gross income of the individual in the year that the deduction is claimed.

Those making decisions about the next phase of life have a lot of options to weigh. With a life care contract, they can feel confident in knowing the health care and community benefits are not the only ones they will receive—tax deductions can go in the "pro" column, too.

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