



How Borrowed Funds Impact the Timing of Income Tax Deductions for Entrance Fees by Karin Vickers

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Residents of Continuing Care Retirement Communities ("CCRCs") have been eligible for a medical expense deduction on Schedule A of their personal income tax return for a portion of the entrance fees paid to the community since the inception of the CCRC concept. This deduction, known as the resident medical deduction ("RMD"), is equal to the percentage of the entrance fee paid to the CCRC associated with the healthcare benefit. The calculation is based on the health care services provided by the CCRC and documented in the resident agreement. The resident is eligible for the deduction in the year that the entrance fee is paid.

Historically, the primary source for the payment of entrance fees has been the proceeds from the sale of their home by the prospective CCRC resident. However, declining real estate values have forced many seniors to reconsider their plans to move into retirement communities. In light of this issue, some CCRCs are exploring non-traditional ways to provide alternatives for prospective residents to finance the entrance fee obligation. Some communities are now accepting promissory notes for the amount of the entrance fee on the new resident's existing home to allow the new resident to move into the community while still trying to sell their home. The resident is then allowed to either pay the entrance fee incrementally over time or delay payment until the resident's previous home is sold. This method of paying entrance fees has given rise to the question of when the entrance fee is considered "paid" for the purposes of taking the RMD.

The general tax rule is that a third party lender (e.g. bank, relative) must be involved in the transaction for a resident to claim the RMD when the entrance fee is paid with borrowed funds. The payment of the entrance fee to the CCRC has to be made with money borrowed directly from a third party lender. The resident is then eligible for the medical expense deduction **in the year the CCRC is paid** by the third party lender and not when the loans to the third party lender are repaid by the resident.

Consequently, the resident providing a promissory note directly to the CCRC would not be deemed to be making payment to the CCRC because no third party lender is involved. The underlying position is that the promissory note may never be paid by the resident to the CCRC, even when the promissory note is secured by collateral. If the promissory note is not paid to the CCRC, the cash-basis taxpayer has parted with nothing more than a promise to pay. Thus, the resident is only considered to have paid the expense when the CCRC is paid. The annual RMD would be limited to the percentage associated with the healthcare benefit of any payments that are made to the CCRC in the year that the payments are made.

If you have any questions on this issue, please contact Sue Bunevich at sbunevich@mslcpa.com or (727) 531-4477.

"P.S. Please be advised that some CCRCs have reported that calls have been received asking for information from someone claiming to be from the Internal Revenue Service. Generally, correspondence from the Internal Revenue Service would be in writing. We recommend avoiding giving

out information over the phone until you are to verify the validity of the caller and the reason for the request. We would be glad to assist your organization if you are solicited in this way in verifying if the requests is from a legitimate source."

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