MarketWatch

TAXWATCH

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At tax time, adding up medical and dental receipts pays off

By Anya Martin

DECATUR, Ga. (MarketWatch) -- Add up your medical and dental receipts and you may find some pain relief in your pocketbook.

That's the prescription from accountants, who say that with incomes down and insurance premiums up more Americans are qualifying to take medical and dental deductions on Schedule A of their individual tax returns.

The most common mistake people make is assuming they need a big health-care expense to qualify since their eligible medical and dental expenses must be greater than 7.5% of their adjusted gross income, said Mary Canning, dean of the School of Taxation and Accounting at Golden Gate University in San Francisco.

While that may have been true in the past, over the last three years Canning, who also has a tax practice, has seen an increasing number of clients meet that 7.5% threshold thanks to skyrocketing insurance premiums, deductibles, co-pays and coinsurance, she said.

If you have employer-sponsored health insurance, find out whether you pay your premiums on a pretax or after-tax basis. Only premiums paid on an after-tax basis may qualify for the medical-expense deduction. For more information, see IRS Publication 502.

Add up out-of-pocket costs

To take the deduction, first, you must itemize rather than using the standard deduction. Second, you can only deduct the amount that is above the 7.5% threshold. And if you are unlucky enough to be subject to the alternative minimum tax, that limit rises to 10% of adjusted gross income.

With a spouse out of work and higher out-of-pocket costs for two elective surgeries, a longtime client is taking the medical deduction for the first time, said Colin E. Blalock, a certified public accountant and shareholder at Atlanta-based Jones and Kolb. Blalock advised that client he could maximize his tax advantage by scheduling both surgeries in 2009. "I do think the deduction eases the blow," he said.

If you were out of work and received the federal government's 65% subsidy for your Cobra coverage, you also can still deduct the remaining 35% that you paid, said Brenda Schafer, manager of tax analysis for the Tax Institute at H&R Block.

Filing tax returns on your own

MarketWatch Personal Finance Editor Andrea Coombes shares tips for self-help tax filers, including saving money while avoiding mistakes.

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While you don't need to add the premium assistance to your gross income, you may have to pay back part of that subsidy if your adjusted gross income was between $125,000 to $145,000 for individuals, and $250,000 to $290,000 if filing jointly. And if your AGI was more than $145,000 or $290,000, respectively you must repay the Cobra subsidy in full as part of your income tax.

If you decided to start your own business, you may be able to deduct premium costs above-the-line on the front of Form 1040. The amount of the deduction depends on your income from self-employment, up to 100%.

However, Cobra payments are not deductible here because they apply to a previous job and not your self-employment, and you can't take the deduction for any month in which you were eligible for a group health plan offered by your or your spouse's employer.

Surprising medical deductions

This year, the IRS didn't add anything to its long list of what qualifies as deductible medical and dental expenses, but many eligible costs may surprise taxpayers because they're not covered fully or at all by insurers, Schafer said.

"People are much more likely to miss deductions," she said.

Some examples of medical expenses often not covered by insurance include hearing aids, glasses, contact lenses, braces for teeth, pregnancy test kits, acupuncture, smoking cessation programs, treatment from a Christian Science practitioner, in vitro fertilization, artificial limbs, a guide dog and even a health club or Weight Watchers meal plan but only if ordered by a physician to treat an ailment such as heart disease.

"One of the things that surprised me was solution for contact lenses," Canning said. "The idea is that it's necessary for the contact lens, and anything that supports a medical device is eligible."

Also often overlooked is the mileage for driving your own car to and from a health-care provider, she said. In 2009, the standard rate for medical miles driven was 24 cents per mile, and tolls, parking fees and fares for taxis, buses and trains are also deductible.

Modifications to your home because of an illness or disability may also be deductible, such as adding ramps, widening doorways, lowering counters and cabinets and installing railings and support bars. However, the IRS makes an exception for any change that increases your home's value and typically disallows elevators for this reason, Blalock said.

Long-term-care insurance premiums are deductible, but amounts are subject to age limits. In addition, 35 states allow a deduction for a percentage of long-term-care premiums.

Still, the IRS does not allow all medical costs. Some nondeductible expenses include nonprescription drugs, cosmetic surgery, funeral expenses, teeth whitening, maternity clothes, household help and life and disability insurance premiums.

"The mistakes that I see most often are deducting life-insurance policies and massages, but maybe that's a Northern California thing," Canning said.

Expenses are considered paid in the year the credit-card charge was made or the check submitted, not when you physically paid the bill.

Helping others can help you

Don't forget that you may be able to deduct medical and dental expenses for an elderly parent, disabled adult child or other chronically ill relative. Qualifying rules to be a dependent for IRS purposes are not as stringent as for an exemption. For example, a senior does not have to live with you but can reside in his or her own home, an assisted living community or a skilled nursing facility.

You do have to have paid over half of that relative's support in 2009 and the relative's annual income must be less than $3,650.

However, up to 30% of families with a special-needs member don't take advantage of all the health-related deductions to which they are entitled, according to the Special Needs Alliance (SNA), a national nonprofit organization of attorneys who specialize in disability and public-benefits law.

"Part of it is due to the fact that [families] are so overwhelmed with what they're dealing with in regard to the person's medical and educational needs, so it falls by the wayside," said Bernard Krooks, founding partner of New York-based Littman Krooks LLP and an SNA past president. "Also, lots of accountants are not familiar with the rules and exceptions for special needs, so maybe that contributes to it as well."

Often-missed deductible expenses include tuition for specialized schools; charges for occupational, speech or physical therapy; transportation for both individual and caregiver for medical purposes; transportation, lodging and registration for medical conferences and seminars related to the dependent's condition; and home improvements.

Generally, room and board at an assisted community wouldn't be deductible, but the money you spend to have a caregiver dispense medication is. Assistance with eating or bathing could be deductible at home or in a long-term-care facility under the following exception: if the service is provided by a licensed health-care practitioner and is required by someone who can't perform at least two activities of daily living without assistance for medical reasons or has severe cognitive impairment, such as Alzheimer's disease.

Even if you can't claim a loved one as a dependent, the recipient of your generosity may be able to get a tax benefit for medical expenses you paid for him for if you made the payment directly to a health-care provider.

Nontaxable gifts were limited to $13,000 per year in 2009, but payments directly to a medical practitioner for care of another person are exempted.

A last-minute move

It's too late now to move that January surgery back to December, but the one thing you still can do to help your 2009 return is make a contribution to your health savings account if you have one, Canning said.

For the 2009 tax year, individuals can contribute up to $3,000 in an HSA, and families can give $5,950 until April 15. All future earnings will be tax-exempt, similar to an IRA, if spent on qualified medical expenses.

Otherwise, Schafer said, start saving receipts and jotting down mileage to ease the pain of your 2010 return.

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