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Taxation of Care Coordination Agreements
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1 Introduction

Although the title of this presentation is Taxation of Care Coordination Agreements, the scope really covers much more than just tax issues. Often when people consider care coordination agreements in the long-term care perspective they think primarily of family as the caregiver(s). While this is largely true there are other options for the care of the elderly. Care can be organized through an agency, through unrelated individuals, or through family. Care can also be arranged through an assisted living facility, nursing home, or continuing care retirement community, even if one of these institutions is providing care, additional services may be required from a friend or family member. In any event, an agreement for the care of a loved one should be in writing, follow traditional contract principals, and corresponding issues such as taxation and insurance should be considered.

2 Melvin's Case

Melvin is 92 years old, his wife and their only son have both predeceased him, as have all of his brothers, sisters, and other family members. Melvin has dementia which has gotten increasingly worse in the last few years. He no longer drives and relies on others to take him to his appointments and to provide meals for him. He is a very friendly gentleman who loves company and is very generous with anyone who comes to visit, often trying to give away money and possessions. He appointed a law firm as agent under his health care power of attorney, agent under his general durable power of attorney, executor of his will, and trustee of his revocable trust. The law firm pays all utilities, taxes, medical expenses, and any other bills out of his trust, therefore Melvin has very few out of pocket expenses other than his entertainment. Melvin depends on his neighbors to take him places therefore his entertainment expenses should be limited. Melvin gets \$500 in cash every Monday which is gone by the following Monday however Melvin can never remember where it goes. A representative from the law firm goes by to visit at least once a week to visit with and check on Melvin. The law firm representative recently noticed that things were missing from Melvin's house like a collection of Hummel figurines worth more than \$5,000, jewelry, and a civil war rifle. A meeting with Adult Protective Services reveals that Melvin's neighbors are removing items from the house because Melvin "gave them away" and they think he will move to a nursing home, however Melvin does not remember giving anything away and there is no discussion of Melvin entering a nursing home. Melvin's health remains good, other than some typical problems associated with aging and he often forgets to eat and take his medication. Melvin tells almost everyone that will listen that he desires to remain in his home until he dies.

2.1 Care. In the above fact pattern, it appears that Melvin may need care in addition to the services the law firm provides. He does not need a nursing home level of care because his health care needs are limited to making sure he gets to the doctor and takes his medications. An in-home nurse would be expensive and more assistance than he needs. Melvin's plan of care needs to be structured around keeping him active, making sure he eats, helping with the household chores, and protecting him from the neighbors who are pilfering his assets.

2.2 Family. In some cases one would consider hiring a family member to come help with Melvin's chores either spending time by the task or by keeping set hours. Yet another option is to have a family member move in with Melvin or have Melvin move in with a family member. Unfortunately, in Melvin's case family is not an option, therefore using a care agency is a likely solution.

2.3 In-home Care Providers. In-home care agencies should be evaluated and selected based on a number of factors. First and foremost, a care agency should be prepared to provide as much or as little care as the individual needs, from companion care and help with chores to round the clock nursing care. A qualified individual, such as a geriatric care manager, should provide a comprehensive assessment of the individual's needs and create a corresponding care plan. The agency should be licensed, insured, and bonded. The individual running the agency should be qualified and experienced and they should be confident in the care that they and their employees provide. Reputation is another strong indicator of the quality of care.

In addition to the quality of care there are additional concerns to address. If the individual is receiving in-home care, then they should be certain that the agency has liability or workers' compensation insurance to protect them against any suit. Another consideration is the protection of valuables. Although the majority of careworkers are honest people, there are those few who are not. Since the caregiver will be spending a number of hours at the home alone with an elderly individual, it may be wise to store any valuable items in a family member's home or in a safe deposit box.

3 The Bradys

Mike Brady is 82 and Carol Brady is 80. Mike recently had a stroke and needs almost constant care. Carol is quite infirmed herself with some age related dementia and severe diabetes. Mike will enter a nursing home as soon as a bed is available and Carol is likely to need long-term care in the future because of her diabetes. Luckily, Mike and Carol have a devoted daughter, Marsha, who is single, lives close by and has offered to retire from her job to help care for her parents. Marsha comes to your office to find out options and how to structure the arrangement.

3.1 Options. Consider Mike and Carol's situation. They have several options with respect to their care. First, they could use an agency such as the one described in Melvin's case to provide a few hours of care each day. Second, Marsha could move in with her parents to provide care. Third, Mike and Carol could move in with Marsha so that she can care for them. Fourth, Mike and Carol can move in to assisted living and Marsha can assist with their needs above and beyond what the facility provides.

3.2 Independent Contractor or Employee? Regardless of the type of care provided, if any caregiver is going to be compensated for providing care, then the nature of the employment must be established so that both parties may properly report their income or expenses for tax purposes.

The first thing to consider is the nature of the arrangement. Are the family members assisting when they can around their work and personal schedules? Do they have set hours or chores? Have they quit their job to assist the parents full time? The IRS considers the following twenty factors to determine whether a person is an employee or independent contractor:

- employee compliance with instructions required
- training
- integration of worker's service into business
- services are rendered personally
- ability to hire, fire, and pay assistants
- continuing relationship
- set hours of work are established
- full time is required
- work performed on business's premises
- services performed in set order or sequence
- oral or written reports required
- payment is hourly, weekly, or monthly
- payment of business or travel expenses
- tools and materials furnished
- worker invests in facilities
- worker can realize a profit or loss
- worker performs services for more than one business at a time
- worker makes services available to the general public
- business has the right to discharge worker
- worker has the right to termination the relationship

While none of these factors are substantial on their own, they can be considered in determining the independent contractor or employee debate. Even if you classify an employee as an independent contractor, the IRS may reclassify them as an employee for tax purposes. If this is the case, then the employer will be held responsible for past withholdings. Perhaps more important than the 20 factor test is the common sense test, if the employee seems like an employee, then they likely are.

If the caregiver is an independent contractor (family member or unrelated party), then having appropriate insurance is again extremely important. If the client is having in-home care, then it is wise to contact the homeowner's insurance company to be certain that the insurance policy would adequately cover any injury on the premises. If the insurance policy is insufficient, then consider purchasing an umbrella policy.

In the example where Marsha is living with her parents and providing constant care, she would more likely than not be considered an employee since her parents' care needs direct the time and manner of her work. Her work would likely be full time, she would not be setting her own hours but would be at the disposal of her parents. Her work would be solely dictated by their needs, and

performed on their premises and at their direction. In this situation, the nature of the arrangement is that Marsha is an employee.

If Mike and Carol move to an assisted living facility and Marsha is providing services which are not provided by the facility, then she may be considered an independent contractor. Her activities would consist of things like taking her parents to the doctor, picking up groceries, prescriptions, and other essentials, and paying the bills. These types of activities are not done from one central location, Marsha can direct when she does each activity and will not constantly act at the direction of her parents. Additionally, her work would not be as tedious and extensive if her parents are in an assisted living facility. Therefore, in this situation, she may be considered an independent contractor.

3.3 Tax Treatment If you treat your caregivers as independent contractors, then you must issue a 1099-misc (see Appendix 1) at the end of the year for all the wages that were paid to them during the year. They will be responsible for the paying the self employment tax on the earnings that are reported to them. The self employment tax on wages less than \$90,000 is 15.3%. If your client chooses to issue 1099-misc to caregivers, whether it is family or otherwise, it is wise to advise these workers in advance arrangement because they caregiver may need to adjust his or her estimated tax payments, or if they have not made estimated tax payments in the past, they may need to begin making such payments. If the caregiver is issued a 1099-misc, they are also responsible for paying FICA taxes (see section 5.2 below) which cannot be offset by a corresponding deduction.

If you choose to treat caregivers as employees, then they are issued a form W-2 (see Appendix 2) at the end of the year, and all necessary FICA taxes have been withheld on their behalf, leaving them subject only to income tax.

4 Care Coordination Agreements

Any agreement which is a payment for services should be in writing, regardless of whether the care agreement was reached as part of a long-term care plan or whether it is simply to move money because a parent wants to compensate their children (see Appendix 3).

4.1 Long-term Care Planning. Virginia Medicaid imposes a penalty for uncompensated transfers or transfers for less than full fair market value (M1450.610). Additionally, there is a rebuttable presumption that transfers from a parent to a child are gifts. Therefore, in Medicaid planning, there should be proof that any transfer is payment for services, especially for those from a parent to a child. A care coordination agreement is a good way to prove that payments are for services. The agreement should detail the type of services to be provided, the salary or rate of payment, as well as how the caregiver will keep track of the services provided.

4.1.1 Salary. Not only must a care coordination agreement be documented, but the payment for services must be reasonable. There is the temptation to transfer a large sum of money as “payment for services” to bring an individual’s assets below \$2,000 and thus immediately eligible for Medicaid. However, if the transfer is unreasonable, then it will be treated as a gift. One way to avoid having compensation be treated as unreasonable is to have a geriatric care manager, or other professional caregiver, evaluate the individual, detail the services which should be provided, then

give a report as to the going rate of care for such services. The care coordination agreement should provide for a salary equal to or less than that which was suggested by the geriatric care manager. The geriatric care manager's report can then be provided along with the Medicaid application as proof that the payment for services was at fair market value.

Currently, in the Hampton Roads area, payment for care services is typically \$17 per hour during the week, \$19 on the weekends, and \$21 per hour on holidays.

4.1.2 Lump-sum payment. Payment for services may also be made in a lump sum so long as the payment remains reasonable for the services. Again, a geriatric care manager may assist in setting the reasonable fee. In this type of transaction, a lump sum payment would be made for current and future services. For example, Carol may transfer to Marsha \$300,000 in exchange for Marsha agreeing to care for Mike and Carol for the rest of their lives.

Under IRS §83(a), this amount would be considered payment for services and included in Marsha's gross income the "first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture." To avoid this result, the transfer may be made to an escrow account. The escrow account should be written just as the care coordination agreement, and should have a third party as the escrow agent. To avoid inclusion in gross income in one year, the agreement should provide for a substantial risk of forfeiture as described in IRC §83(c). A sample escrow agreement will be available in the upcoming supplement of "Representing the Elderly or Disabled Client," by Hook and Begley, published by RIA.

If the transfer is a lump sum in consideration of Medicaid eligibility, the escrow agreement should also provide that any amount remaining in the escrow account is paid to the caregiver if they have substantially performed under the agreement in the event of the death of the individual receiving care. If the caregiver has not substantially performed, then the remaining funds are payable to the decedent's estate subject to the claims of the Commonwealth for recovery costs of Medicaid long-term care services provided.

The amount of the lump sum must still be reasonable. An acceptable way to calculate the amount to place in the escrow account is to determine the number of hours per year required to care for the individual or individuals (again a geriatric care manager should be able to assist with this) then multiply the number of hours by the current going in home hourly rate. Take the yearly estimate of cost of care and multiply by the life expectancy of the individual. Life expectancy should be based on actuarially sound tables such as the Social Security Administration tables (see Appendix 4).

In the above example, suppose Mike has died and Carol had entered the nursing home. She is 80 years old and has a life expectancy of 8.94 years (Social Security Administration actuarial tables). A geriatric care manager has assessed that she will need about 12 hours of assistance per week, outside of what the nursing home provides, and that \$18 an hour is an acceptable average rate, for a total weekly expense of \$216. Over Carol's life expectancy she may spend approximately \$100,415. This total amount can be placed in the escrow agreement. Since the agreement is irrevocable and the amount in the account will not revert to Carol, the transfer of \$100,415 to the

account is a transfer for value and should not be penalized by Medicaid. Marsha will not realize the entire \$100,415 in income in the year of the transfer because the agreement has a substantial risk of forfeiture. Marsha will only realize the amount paid out to her in each year.

5 The Nanny Tax

5.1 Getting Started. If your client is paying either a third party or a family member out of pocket for their care, then they have become an employer. Although they may avoid such filings as a quarterly 941, they must follow all the rules and regulations surrounding employers with household employees. This is commonly called the “nanny tax.”

To get started, the client needs to complete Form SS-4 to apply for an EIN number and each employee must fill out Forms I-9 and W-4 (See Appendix 5 for Forms SS-4, I-9, and W-4). Form I-9 is an immigration form which verifies that the individual is able to work in the United States. Although it may seem a bit ridiculous in some instances, if you are paying any person I recommend that you have these completed, more than one political career has been stunted for failing to verify the status of employees.

5.2 FICA. The employer is responsible for paying 7.65% of the employees wages in FICA (medicare and social security) tax. However, the IRS makes the employer also responsible for making certain that the employee’s 7.65% FICA taxes are paid. Therefore, the employer almost always withholds FICA taxes from each employee’s paycheck and sends that amount in with their individual tax return in the spring.

5.3 FUTA. In addition to FICA taxes the employer must pay FUTA (federal unemployment) taxes which is currently 6.2% of the first \$7,000 in wages paid. However, if the employer also pays all state unemployment taxes on or before April 16, 2007, then the employer may take a credit of up to 5.4% making the effective FUTA tax 0.8% of the first \$7,000 in wages, or \$56. FUTA taxes are not withheld from an employees paycheck, they are the responsibility of the employer.

5.4 Income Tax Withholding. The employer may, but is not required to, withhold income taxes from each employee’s paycheck. If the caregiver will owe taxes at the end of the year, whether because of salary, retirement income, or capital gains, it is more likely than not a good idea and beneficial to them to withhold income taxes to avoid increasing their out of pocket tax burden on April 15 each year. Many individuals depend on their tax refund and not withholding income taxes will negatively impact the refund. At the end of the year the employer will issue a W-2 to the employee, send a W-3 to the IRS, and report and pay the withheld amounts with the Schedule H on their 1040.

5.5 Schedule H. If the employer is withholding FICA, FUTA, and income taxes but not filing a Form 941 (Employer’s Quarterly Tax Return), then these amounts must be paid to the IRS. These amounts are reported on the individual employer’s tax return on Schedule H. These amounts are calculated based on amounts paid and are not subject to any deductions or credits. (See Appendix 6 for a sample federal tax return with a schedule H)

5.6 State Unemployment and Income Tax. Virginia's unemployment tax (SUTA) is 2.69% of the first \$8,000 in wages earned. The employer becomes liable for unemployment when they pay more than \$1,000 in a quarter in wages. File Form FC-27, payments must be made quarterly. Employer may also withhold Virginia income taxes for each employee by filing Form VA-5 (see Appendix 7 for Virginia tax forms).

6 Worker's Compensation

Virginia Code §65.2-101 does not include in the definition of an employee, employees of any person, firm, or private corporation that has regularly in service less than three employees. Therefore clients employing one or two of their family members are not required to have a worker's compensation insurance policy. However, if the client has three or more children and they all are receiving payment for services, even if they are all "part-time" employees, then the client is bound by the terms of Chapter 65.2 (see Virginia Code §65.2-300).

Although not being required to maintain worker's compensation is likely seen as a benefit for the client, what happens to the caretaker if he or she is injured while helping their parent? Most parents would want their children to be compensated if they were injured however, for Medicaid eligibility, the parent cannot continue to pay the child if the child is no longer providing service. Workers' compensation policies, through certain companies such as State Farm, are available for employers with less than three employees and may be something to consider.

Again, consider Mike and Carol. Suppose Marsha moved in with them to be a caretaker and they were attempting to obtain community based Medicaid for Mike. Marsha has quit her job to take care of her parents, is unmarried, and has no health insurance. Her compensation was paid in a lump sum and was contributed to an escrow account with a substantial risk of forfeiture. Marsha injures her back while lifting Mike. She has no insurance to pay for her care and her income was based on an hourly wage which is no longer being paid to her since she is not caring for her parents. Her parents can not pay her expenses since payment would be an uncompensated transfer and they have diminished assets. In this situation, a workers' compensation claim would be an excellent way to take care of Marsha without jeopardizing any long-term care planning done by Mike and Carol.

7 Room and Board

Room and board at the place of employment or for the convenience of the employer is not income to the Employee. Therefore in-home caregivers are not taxed on the value of those benefits and the amounts need not be provided to the IRS.

8 Deduction for Long-term Care Expenses

Long-term care expenses can be deducted, including assisted living facility expenses and in-home care expenses, so long as the individual has been diagnosed by a doctor as being chronically ill and the care is provided pursuant to a plan of care prescribed by a doctor. If your client is going to deduct their care expenses, then be certain to have a written record of the diagnosis and plan of care. Employment taxes such as FICA, FUTA, and SUTA can be deducted only for the portion of payment directly related to Medical care. In practicality, calculating the amount of the deduction

is extremely difficult.

9 Conclusion

In conclusion, there are many types of care agreements and many options surrounding care agreements. They are useful tools for long-term care planning but require thought and consideration. The tax consequences surrounding them are not extremely difficult but must be taken into consideration for a complete agreement. IRS Publication 926 (see Appendix 8) is a useful tool as well as the Nanny Tax website (<http://www.householdemploymenttaxes.com>).