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Pre-Conference:

Tax Intensive

Wednesday, October 14, 2015

Stetson University College of Law &
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present:
2015 Special Needs Trusts
National Conference

October 14-16, 2015
The Vinoy Renaissance Resort & Golf Club
St. Petersburg, Florida

Pre-Conference: Tax Intensive
Wednesday, Oct. 14, 2015

A program focused on tax-related questions and answers that elder law attorneys must know.

9:00-10:00 a.m.
The Role of MAGI in Special Needs Planning
Modified Adjusted Gross Income, or MAGI, used to be the concern of tax preparers and tax attorneys. As a result of the Affordable Care Act, everyone working in the field of special needs planning should have an understanding of MAGI and how it is used under the Affordable Care Act to determine eligibility for expanded Medicaid, tax credits and reductions in cost sharing and what MAGI means for clients.
Dean Christopher M. Pietruszkiewicz

10:00-11:00 a.m.
Income Under the Tax Rules: Not Everything A Trustee Receives is Taxable Income
Section 61 of the Internal Revenue Code defines “gross income” for tax purposes, but that is just the starting point. A review of the Code, Regulations and accounting practices will provide a better understanding of taxable income for a special needs trust -- or, indeed, for an individual.
Robert B. Fleming and Nell Graham Sale

11:15 a.m.-12:15 p.m.
The Interplay of Income, Estate and Gift Tax
As many as three different tax regimens are involved in administration of a special needs trust. The interrelationships among those systems help lay the framework for a better understanding of income/principal designations, as well as public benefits calculations. Learn more about income taxation (including capital gains taxes), estate taxation (including generation skipping taxes) and gift taxation -- and have fun doing it.
Robert B. Fleming, Nell Graham Sale

1:00-2:00 p.m.
What is a Grantor Trust, and When Do You Need an EIN?
One of the most frequently asked questions about SNTs and taxes is the question of whether a SNT needs an EIN. This session will cover a review of the actual CFRs on tax filings, walk the audience through a 1041 and answer definitively the question of whether a SNT needs an EIN!
Nell Graham Sale

2:00-3:00 p.m.
IRAs, Qualified Plans, Pensions, etc. with the SNT Named as Beneficiary
This session will provide samples and language for an accumulation trust, some actual calculations of the dollar amounts in some hypothetical cases, language for a beneficiary designation, and a discussion analyzing trust distributions and payments.
Bradley J. Frigon

3:15-4:15 p.m.
The Devil and the Details: Employment-Related Tax Issues and Special Needs Trusts
This session will focus on tax considerations that occur when a Special Needs Trust employs caregivers for the beneficiary, and how hiring of a family member should be handled. When for tax purposes can independent contractor status apply to a caregiver and when is the caregiver considered an "employee" of the trust? The responsibilities of the Trust as employer as to withholding FICA and income taxes, worker's compensation and unemployment taxes will be discussed.
Katherine Barr

2015 Special Needs Trusts National Conference

Pre-Conference: Tax Intensive

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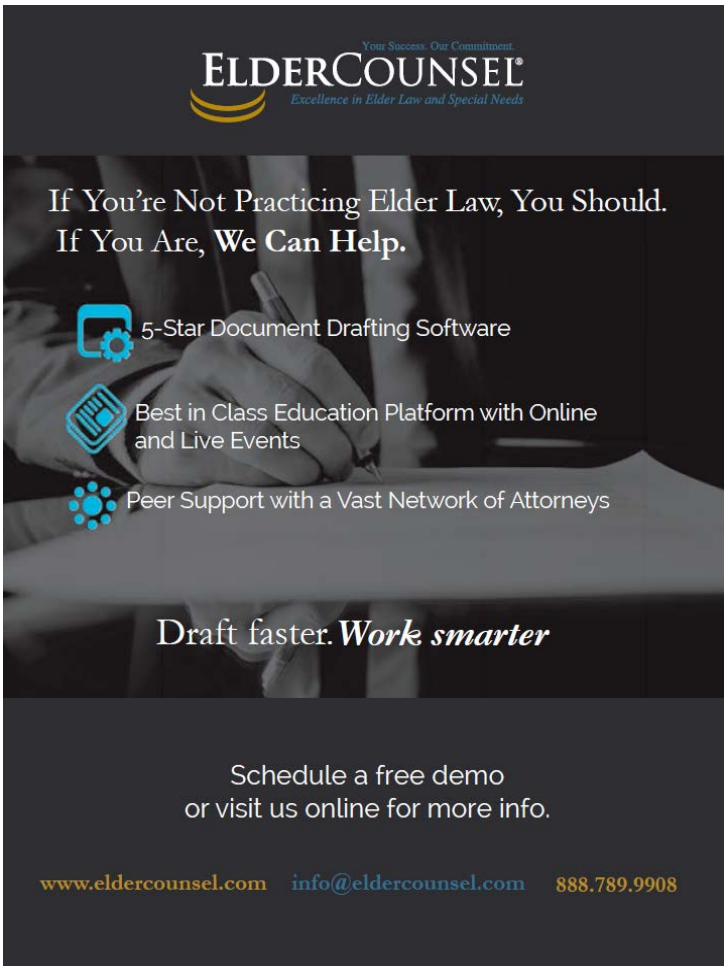

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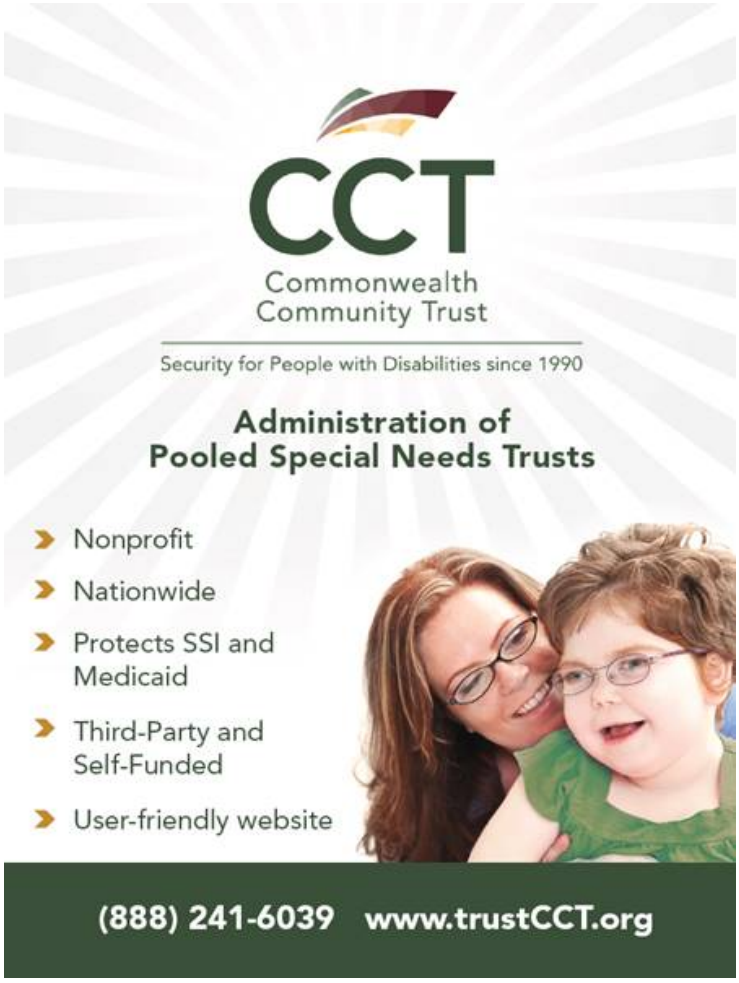

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Wednesday, October 14, 2015
9:00 A.M. – 10:00 A.M.

The Role of the MAGI in Special Needs Planning

Presenter:
Dean Christopher M. Pietruszkiewicz
Dean, Stetson University College of Law
Gulfport, Florida

- NAELA News - Magi and Its Importance for Special Needs Clients
- National Health Law Program – The Advocate's Guide to MAGI
- Center for Medicaid and CHIP Services- MAGI: Medicaid and CHIP's New Eligibility Standards
- 26 United States Code, 2010 Edition- §36. Refundable credit for coverage under a qualified health plan
- Code of Federal Regulations -§1.36-B-1 Premium tax credit definitions
- Code of Federal Regulations §435.603 Application of modified adjusted gross income (MAGI)
- 2014 - Instructions for Form 8962
- 2014 - 1040 U.S. Individual Income Tax Return
- UC Berkeley Labor Center - Modified Adjusted Gross Income under the Affordable Care Act – July 2014
- PowerPoint

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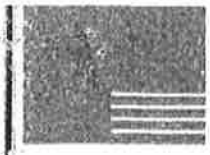

By Bradley J. Frigon, CELA, CAP

MAGI and Its Importance for Special Needs Clients

Special Needs Planners should know about the new methodology to determine income.

One of the most important changes brought about by the Patient Protection and Affordable Care Act (ACA) is the introduction of a new methodology to determine income. Beginning in 2014, modified adjusted gross income (MAGI) will be used as the measure to ascertain eligibility for most Medicaid and Children's Health Insurance Program (CHIP) applicants, as well as eligibility for tax credits when purchasing regular Affordable Care Act (ACA) coverage.[1, 2] States choosing to participate in the optional ACA expansion will cover most nonelderly citizens (including childless adults, parents, and individuals with disabilities) with incomes of up to 133 percent of the Federal Poverty Level (FPL).[3]

Understanding the concept of MAGI is of critical importance for attorneys working with special needs clients. Because trust income allocated to a beneficiary is part of MAGI, an attorney drafting first-party and third-party special needs trusts must understand the income tax rules that apply to such trusts.

From AGI to MAGI

MAGI is intended to create a uniform nationwide system to calculate income. It is based on the taxable income of the individual or individuals filing a joint return. The starting point for calculating MAGI is adjusted gross income (AGI). AGI is calculated by adding income on Lines 7 through 21 on Form 1040, which is then combined on Line 22 as total income. From total income certain above-the-line deductions on Lines 23 through 35 (e.g., trade and business deductions, losses from sale of property, and alimony payments) are subtracted to reach AGI, which is reported on Line 37 of Form 1040.

MAGI and AGI are close in value; MAGI is calculated by adding or subtracting from AGI certain adjustments such as interest on state and local bonds, qualified tuition expenses, passive loss or passive income, and taxable Social Security payments.

Beginning in 2014, qualifying individuals will be able to receive premium tax credits toward the purchase of health care coverage on a public or private exchange. The credit is an advanceable, refundable tax credit, which means that taxpayers are not required to wait until the end of the tax year to benefit from the credit and may claim the full credit amount even if they have little or no federal income tax liability (advance payments will actually go directly to the insurer). The amount of the tax credit will depend on the MAGI of the tax-filer (and dependents), the premium for the exchange plan in which the tax-filer (and dependents) is (are) enrolled, and other factors. In certain instances, the credit amount may cover the entire premium and the tax-filer will pay nothing toward the premium. In other instances, the taxpayer may be required to pay part (or all) of the premium.

Bradley J. Frigon, CELA, CAP, Englewood, Colo., is NAELA President and a NAELA Fellow. This article was originally published in *The ElderLaw Report*. Reprinted with permission.

1 P.L. 111-148, as amended.

2 42 U.S.C. 1396a(e)(14).

3 42 U.S.C. 1396a(a) (10)(A)(i)(VIII).

The Benefits of Increasing MAGI

The calculation of MAGI will have a significant impact on an individual's eligibility for Medicaid programs and tax credits. In states that have not adopted Medicaid expansion, it may be advantageous for your client to increase MAGI to purchase private insurance on an exchange. For example, consider a young adult woman residing in Florida, age 23, whose income is $225/week ($11,700/year), all from a third-party special needs trust (SNT). Florida did not adopt Medicaid expansion and she does not qualify for the premium tax credit because her MAGI must exceed approximately $16,000 per year. If her MAGI does exceed $16,000 per year, she can buy private health insurance with the following attributes:

Monthly Premium	$ 8/mo.
Annual Deductible	$500/yr.
Maximum Out-of-Pocket	$750/yr.
Co-payments/Coinsurance:	
Primary Doctor:	$ 25
Specialist Doctor:	$ 35
Generic Prescription:	$ 17
ER Visit:	
Coinsurance After Deductible	20%

Under Florida Medicaid's "Medically Needy" program, her monthly cost is $805. Ironically, our hypothetical client can qualify for Medicaid at a monthly cost to her of $805 unless she can increase her MAGI above $16,000 per year. If she can manage that, she can purchase her own private insurance with a monthly premium of $8, under which she can select her doctor and significantly lower her co-pays.

Trust Income and MAGI

A grantor trust is not treated as a separate taxpayer. Instead, the income from a grantor trust is taxed to the grantor (or sometimes to another person) because he or she holds some prescribed interest in or control over the trust's assets. If the grantor is not deemed to be the owner of a portion of the trust assets, then the trust is taxed as a separate entity, for federal income tax purposes. If a trust is taxed as a separate entity, then it will be taxed as a simple or complex trust, unless the trust is a charitable trust.

A non-grantor trust has similar tax rates as individuals under Sec. 1 of the Internal Revenue Code of 1986, as amended (the Code). Although similar tax rates (15 percent, 25 percent, 28 percent, 33 percent, and 35 percent) apply to both individuals and trusts, the tax brackets for a trust are more compact than for an individual. In 2013, a trust with taxable income over $11,950 is taxed at a 39.6 percent-rate bracket. In contrast, an unmarried individual must have taxable income over $400,000 to reach the 39.6 percent rate bracket for 2013 (or taxable income of $450,000 for married individuals filing joint returns).

For a non-grantor trust, it is important to understand the concept of distributable net income (DNI). To prevent double taxation of income, trusts are allowed to deduct the lesser of DNI or the sum of the trust income required to be distributed and other amounts "properly paid or credited or required to be distributed" to the beneficiaries. This includes distributions that can be made out of either income or trust principal to the extent they are made from trust income. DNI is calculated based on accounting income less any tax-exempt income net of allocable expenses. The deduction amount consists of each class of item included in DNI (as a proportion of DNI) unless the trust instrument or state law explicitly prescribes a different allocation. Thus, the actual distribution must also be reduced by the proportionate share of net tax-exempt income. The accounting method and period of the estate or trust determine when the deduction may be claimed; the beneficiary's tax year is not relevant.

Understanding the concept of MAGI is of critical importance for attorneys working with special needs clients. Because trust income allocated to a beneficiary is part of MAGI, an attorney drafting first-party and third-party special needs trusts must understand the income tax rules that apply to such trusts.

Gains from the sale or exchange of capital assets ordinarily are excluded from DNI unless, pursuant to the terms of the governing instrument or applicable local law, such gains are allocated to income. The following examples will help illustrate the impact of trust taxable income on a beneficia-

ry's calculation of MAGI. For purposes of this discussion, a SNT will be taxed as a grantor trust or a complex trust. In each example, the trust has total income of $25,000 and total expenses of $10,000. Trust distributions for the benefit of the beneficiary for Example 1 and 2 total $20,000. In Example 3, the trust is treated as a grantor trust for income tax purposes. The beneficiary's only income is SSI payments of $8,544.

Taxable Income	
Taxable Interest	$ 4,500
Tax-Exempt Interest	$ 500
Dividends	$10,000
Capital Gains	$10,000
Total Income	$25,000
Deductions	
Trustee Fees	$ 5,000
Attorney's Fees	$ 5,000
Net Income	$15,000

Example One: Taxable Income for a Complex Trust

In this example, the trust income is made up of taxable interest, tax exempt interest, dividends, and capital gains.

Taxable Income	
Taxable Interest	$ 4,500
Tax-Exempt Interest	$ 500
Dividends	$10,000
Capital Gains	$10,000
Total Income	$25,000
Deductions	
Trustee Fees	$ 5,000
Attorney's Fees	$ 5,000
Gross Income	$15,000
Less Exemption	($ 3,900)
Distributions to Beneficiary	$20,000
2013 Trust Taxable Income	$ 6,100
2013 Trust Tax Liability	$ 548
MAGI	$ 5,000
2013 Beneficiary Tax Liability	$ 0

Part of the trustee fee must be allocated to tax-exempt income as a proportion of gross accounting income. Gains from the sale or exchange of capital assets are not ordinarily part of DNI. The personal exemption amount is $3,900 for a non-grantor trust that qualifies as a qualified disability trust. In this example, the distribution deduction for the trust is $4,832. On the Form 1040 for the beneficiary, line 37 would show the AGI as $4,832. The beneficiary's MAGI is calculated by adding the $168 of tax-exempt interest to the AGI of $4,832. (Note: There are exhibits illustrating these figures available at http://attorney.elderlawanswers.com/uploads/media/documents/june_14_feature_exhibits_4.pdf)

Example Two: Taxable Income for a Complex Trust

In Example Two, the trust income does not include capital gain income but only income from taxable interest, tax-exempt interest, and dividends.

Taxable Income	
Taxable Interest	$ 4,500
Tax-Exempt Interest	$ 500
Dividends	$ 20,000
Capital Gains	$ 0
Total Income	$25,000
Deductions	
Trustee Fees	$ 5,000
Attorney's Fees	$ 5,000
Gross Income	$15,000
Less Exemption	($ 3,900)
Distributions to Beneficiary	$20,000
2013 Trust Tax Liability	$ 0
MAGI	$15,000
2013 Beneficiary Tax Liability	$ 0

Part of the trustee fee must be allocated to tax-exempt income as a proportion of gross accounting income. There are no gains from the sale or exchange of capital assets; as a result, DNI is increased to $14,700. The personal exemption amount is $3,900 for a non-grantor trust that qualifies as a qualified disability trust. As shown in the trust tax form, the distribution deduction for the trust is $14,700. On

Line 37 of the beneficiary tax form AGI is $14,700.

The beneficiary's MAGI of $15,000 is calculated by adding the $300 of tax-exempt interest to AGI of $14,700.

Example Three: Taxable Income for a Grantor Trust

Taxable Income	
Taxable Interest	$ 4,500
Tax-Exempt Interest	$ 500
Dividends	$10,000
Capital Gains	$10,000
Total Income	$25,000
Deductions	
Trustee Fees	$ 5,000
Attorney's Fees	$ 5,000
2013 Trust Tax Liability	$ 0
MAGI	$25,000
2013 Beneficiary Tax Liability	$ 0

Trustee fees and expenses are an itemized deduction to the beneficiary subject to a 2 percent floor. In 2013, the standard deduction for a single individual is $6,100. The beneficiary cannot deduct trustee fees since the standard deduction exceeds the beneficiary's itemized deductions listed on Schedule A. Trustee fees and expenses do not impact MAGI since only above-the-line deductions are subtracted from gross income to calculate MAGI. As shown on the beneficiary tax form, Line 37, AGI is $24,500. The beneficiary's MAGI of $25,000 is calculated by adding the $500 of tax-exempt interest to AGI of $24,500. Although SSI payments are not taxable, SSDI and Social Security payments may potentially be taxable and therefore part of MAGI, if the beneficiary's income exceeds certain thresholds.

Three Planning Opportunities

Whether the goal is to increase or decrease MAGI in any given year for a beneficiary, an attorney advising the trustee should be aware of three available tax-planning opportunities. For a complex trust, with respect to discretionary distributions of income or principal, the year of payment by the trust will generally be the year of deduction and will set the year for determining inclusion of the payment as income. If within the first 65 days after the close of a taxable year of a trust, an amount is properly paid or credited and the fiduciary makes a proper election, the distribution is treated as having been made on the last day of the preceding taxable year. While the distribution must be made within 65 days of the start of the new year, the election must be made no later than the deadline for filing the fiduciary income tax return for the taxable year for which the distribution is treated as made, plus extensions. Because trusts must use the calendar year, the elections deadline for trusts is April 15, plus any extensions.

How trust assets are invested will dramatically impact taxable income. To increase income, investment allocation should focus on dividend-paying stocks, REITS, utilities, and preferred stocks. The attorney must understand the impact of an income-driven investment allocation and draft the trust document to allow the trustee authority to invest primarily for income without consideration of the remainder beneficiaries. The trustee should work with a qualified investment adviser who understands these issues.

The drafting attorney should consider incorporating an income tax toggle provision into the trust document. A toggle provision will allow the trust to be taxed as a complex trust or as a grantor trust depending on the power granted or withdrawn for any given tax year. The most commonly used toggle provision is the power reserved to the grantor to reacquire any property constituting the trust estate by substituting other property of equivalent value. A toggle provision cannot be applied retroactively but only prospectively. In other words, if on December 31, 2013, the grantor is granted the authority to substitute property under the terms of the trust document, grantor trust treatment will be applied to the trust for the tax year 2014.

The drafting attorney should consider incorporating an income tax toggle provision into the trust document.

Conclusion

The calculation of MAGI will have a significant impact on an individual's eligibility for Medicaid programs and tax credits, so understanding the concept of MAGI is of critical importance for attorneys working with special needs clients. Because trust income allocated to a beneficiary is part of MAGI, an attorney drafting first-party and third-party special needs trusts must understand the income tax rules that apply to trusts, including the concept of DNI. Whether the goal is to increase or decrease MAGI for a beneficiary, an attorney advising the trustee should be aware of the available tax planning opportunities. ■

NHeLP
NATIONAL HEALTH LAW PROGRAM

The Advocate's Guide to MAGI

PREPARED BY

The National Health Law Program
Byron J. Gross, Of Counsel
Wayne Turner, Staff Attorney
David Machledt, Policy Analyst

October 2013
(updated February 2014)

Updated February 2014

This version includes updated IRS tax filing thresholds and exemption amounts, and it also has links to new IRS publications. It slightly revises the section on when VA Benefits are considered as part of MAGI. It also expands the discussion of married, separated, and divorced couples with examples of when individuals can be married but "considered unmarried" under federal tax law. Additionally, a new section (Section VII) describes the differing rules for establishing the applicable Federal Poverty Lines in both Marketplace and Medicaid eligibility determinations.

Acknowledgements

We want to recognize and thank those who contributed their time, expertise and thoughtfulness to the work of putting together this Guide. Careful review and helpful editing and comments were provided by NHeLP's Legal Director, Jane Perkins, and NHeLP Attorneys Kim Lewis, Erin Armstrong, Dipti Singh and Sonal Ambegaokar. Valuable outside assistance was kindly provided by Alice Bussiere of the Youth Law Center, Anna Rich of National Senior Citizens Law Center, Jenny Rejeske of the National Immigration Law Center, Amanda Dunlap, Visiting Assistant Professor and Director, Low Income Taxpayer Clinic UDC David A. Clarke School of Law, and Charles G. Jeane, Former Visiting Assistant Professor and Director of the Low Income Taxpayer Clinic at the UDC David A. Clarke School of Law. NHeLP Legal Interns Colleen Krisulevicz, Rachelle Sico and Holly Pearson did research for the Guide. Cite checking and proofreading was done by law students Kroopa Desai, Alisha Johnson, Brian Yagi and Cassie Gourash, some of whom helpfully stepped in when left high and dry without their externships during the October 2013 federal government shutdown! And, finally, thanks to our Executive Director, Emily Spitzer, who supports us and keeps our ship sailing forward so NHeLP staff can produce work like this.

Byron J. Gross, Of Counsel
Wayne Turner, Staff Attorney
David Machledt, Policy Analyst

National Health Law Program

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Table of Contents

X. Appendices

Glossary of Acronyms

ABD	Aged, Blind, and Disabled
ACA	Affordable Care Act
AGI	Adjusted Gross Income
AFDC	Aid to Families with Dependent Children
AFDC-96	Aid to Families with Dependent Children as of July 16, 1996
APTC	Advance Premium Tax Credits
BCCTP	Breast and Cervical Cancer Treatment Program
CDC	The Centers for Disease Control and Prevention
CFR	Code of Federal Regulations
CHIP	Children's Health Insurance Program
CMS	Centers for Medicare & Medicaid Services
CSR	Cost Sharing Reductions
FFM	Federally Facilitated Marketplace
FMAP	Federal Medical Assistance Percentage
FPL	Federal Poverty Level
FSA	Flexible Spending Arrangement
HCBS	Home and Community-Based Services
HHS	The United States Department of Health and Human Services
IAP	Insurance Affordability Programs
IRC	Internal Revenue Code
IRS	Internal Revenue Service
MAGI	Modified Adjusted Gross Income
MOE	Maintenance of Effort
QHP	Qualified Health Plan
SPA	State Plan Amendment
SSA	Social Security Act
SSI	Supplemental Security Income
SSDI	Social Security Disability Insurance
USC	United States Code

I. Introduction

One of the significant changes brought about by the Affordable Care Act (ACA) is the introduction of a new methodology to evaluate eligibility for Insurance Affordability Programs (IAPs): Modified Adjusted Gross Income (MAGI).[1] MAGI will be used to evaluate available income for most Medicaid and Children's Health Insurance Program (CHIP) applicants and enrollees beginning in 2014 (or earlier in a few states that have opted for early implementation). The MAGI methodology differs significantly from prior Medicaid rules. MAGI will also be used to determine eligibility for Advance Premium Tax Credits (APTCs) and Cost Sharing Reductions (CSRs) for applicants for financial assistance under the new insurance Exchanges (increasingly referred to as "Marketplaces").[2] MAGI aims to introduce nationwide uniformity to a system of calculating income that previously varied considerably from state to state.

This Advocate's Guide explains how MAGI works.[3] It sets forth, in as much detail as possible, the guidelines that CMS has developed to implement and govern this new methodology.[4] This Guide is similarly meant for national use, and we point out the few areas where states have leeway to shape policies that affect the MAGI calculations.

The Guide will be an ongoing reference for advocates providing direct services to clients who have questions or problems pertaining to eligibility for health care affordability programs. NHeLP is publishing this Guide solely in electronic format, so we can efficiently update, expand and improve it as appropriate. While advocates may want to print out a version for desk reference, we suggest regularly checking the NHeLP website to obtain the most up-to-date version. As we are all making the transition to this new methodology and learning the "ins and outs" of it together, we welcome any suggestions for improvement or for further clarification.

A. Overview of MAGI Methodology

MAGI aims to replace the diversity of income counting methodologies currently used in Medicaid, which entail numerous income deductions and disregards that vary from state

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[1] Insurance Affordability Programs (IAPs) include Medicaid, CHIP, Basic Health Plan (a state option not yet operational anywhere), Advance Premium Tax Credits and cost-sharing assistance for enrollees in Qualified Health Plans (QHPs) through the health insurance Marketplaces (also known as Exchanges).

[2] A more accurate term might be premium tax credits, rather than *Advance* Premium Tax Credits, because the tax credits available to subsidize premiums for insurance plans purchased through the new Exchanges for persons up to 400% of the Federal Poverty Level need not be taken in advance. However, because "APTCs" is commonly used as an abbreviation for these subsidies, we use that term. We generally use the term "Marketplace" herein, but it is interchangeable with "Exchange."

[3] The term "MAGI" is commonly used to describe the entire new methodology, which encompasses far more than a simple calculation of Modified Adjusted Gross Income. Thus, in this Guide, the term MAGI may refer to the income itself, as well as the broader methodology used to determine eligibility.

[4] These notes include citation to federal documents, primarily Dear State Medicaid Director letters. We do not link to these letters because the web address may change. To begin your search to obtain a DSMD, cited below, go to http://www.medicaid.gov/Federal-Policy-guidance/federal-policy-guidance.html.

to state. MAGI is also intended to be a more simplified methodology that will increase uniformity across the states and across Insurance Affordability Programs.

MAGI has two principal components: income counting and household composition. First, MAGI counts income according to federal tax law. Second, MAGI rules determine household composition and family size, with different rules applying in Marketplaces and Medicaid. Income and family size are then compared to the Federal Poverty Level (FPL) to determine which Insurance Affordability Programs may be available to someone seeking an eligibility determination.

As noted, MAGI applies across Insurance Affordability Programs. Thus, it will affect:

- APTCs: Individuals who purchase insurance through a Marketplace and whose income is at or below 400% FPL qualify for APTCs to help pay for monthly insurance premiums. Those making up to 250% FPL may receive additional assistance to reduce cost sharing, including co-pays, deductibles, and co-insurance, as well as lowering out-of-pocket limits.

- Medicaid: Medicaid programs have historically provided health coverage to low-income families with children and the aged, blind and disabled. The ACA extends Medicaid eligibility to a new adult expansion group, set at 133% FPL, although states can elect to cover more people under the adult expansion by establishing a higher income threshold. Other Medicaid eligibility categories, such as parents and caretaker relatives, can have income thresholds as high as 200% FPL (or higher for limited coverage options).[5]

- CHIP: Because of the strong public interest in providing health coverage to children, CHIP programs often set much higher income eligibility thresholds – as high as 300% FPL in some states.[6]

Because eligibility thresholds may differ for children and adults, members of a single family may qualify for different programs. For example, a mixed-eligibility family could have children in CHIP and parents with APTCs in the Marketplace.

B. How MAGI Relates to Federal Taxes

MAGI is defined under Section 36B of the Internal Revenue Code (IRC). Subject to a few exceptions that apply to all Insurance Affordability Programs, and a few more exceptions that apply only to CHIP and Medicaid, MAGI eligibility is based on adjusted

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[5] *See* Kaiser Family Foundation, *Adult Income Eligibility Limits at Application as a Percent of the Federal Poverty Level (FPL)* (Jan. 2013), http://kff.org/medicaid/state-indicator/income-eligibility-low-income-adults/.

[6] *See* Kaiser Family Foundation, *Income Eligibility Limits for Children's Separate CHIP Programs by Annual Incomes and as a Percent of Federal Poverty Level* (Jan. 2013), http://kff.org/other/state-indicator/income-eligibility-separate-chip-prog/.

gross income as reported for federal income tax purposes. Because the calculation of income generally follows the rules for federal income tax reporting, the determination of what income counts is fairly straightforward.

However, under MAGI, the *types* of countable income differ significantly from current Medicaid and CHIP income counting rules. Some types of currently countable income will be excluded under MAGI, while MAGI includes other types of income not counted under current rules. Advocates accustomed to working with these programs will have to familiarize themselves with these changes.

Significantly, none of the previous Medicaid/CHIP income deductions and disregards will apply under the MAGI methodology.[7] Rather, Medicaid and CHIP programs will apply an across-the-board 5% disregard when (as explained below) overall eligibility is at stake. As a result, some enrollees who most benefit from current deductions and disregards stand to lose eligibility in the switch to MAGI, despite the "conversion" of current income limits to higher levels to account for the removal of deductions and disregards. On the other hand, others who wouldn't previously have been eligible will gain eligibility. This across-the-board disregard is not used for APTCs/CSRs.

Much more complex than the rules on countable income are the rules defining "household" size and whose income is counted. Like the rules on the types of countable income, the rules defining household composition differ substantially from previous Medicaid and CHIP rules. The MAGI household definition rules for Medicaid and CHIP also differ from the MAGI household definition rules for APTCs/CSRs. Accordingly, each application for insurance affordability programs will require a two-step analysis to determine the applicant's Marketplace household size for purposes of APTC/CSR eligibility, and the Medicaid/CHIP household size.

Note that certain decisions by a taxpayer in regard to how to file taxes could have an impact on eligibility for IAPs, or the amount of subsidy. But such decisions, such as whether a couple should file jointly or whether a taxpayer should claim someone as a dependent, will also have an impact on how much tax will be paid. This is an individualized determination, and in some cases advocates should refer clients to a tax accountant or tax attorney for advice.

C. No Asset Test

The ACA prohibits consideration of assets, or resources, that an individual or family owns for MAGI-based eligibility determinations across all IAPs.[8] Many states already disregard assets for children's Medicaid and CHIP eligibility, and nearly half the states have eliminated Medicaid asset tests for parents and caretakers. Nevertheless, many individuals stand to gain eligibility due to the elimination of asset tests.

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[7] 42 U.S.C. § 1396a(e)(14)(B).
[8] *See* 42 C.F.R. § 435.603(g).

D. Limited Applicability of MAGI

Though the MAGI methodology will apply to all eligibility determinations for APTCs/CSRs and CHIP, the ACA exempts certain Medicaid eligibility categories from MAGI. For example, persons linked to eligibility through disability or age (65 and over) will not be subject to MAGI. Current state-specific income and resource counting rules will continue in effect for exempt eligibility categories. Thus, advocates will have to continue understanding existing rules, while at the same time learning the new MAGI system.

States also use MAGI to calculate the appropriate Federal Medical Assistance Percentages (FMAP). Services for the new adult group are entitled to an enhanced federal match.[9]

E. Legal Authorities Governing MAGI

1. Legislation

The Patient Protection and Affordable Care Act - Pub. L. No. 111-148, 124 Stat. 119 (2010). That statute was amended by the Health Care and Education Reconciliation Act (Pub. L. No. 111-152, 124 Stat. 1029 (2010)), which the President signed on March 30, 2010.

2. United States Code

- 42 U.S.C. § 1396a(a)(10)(A)(i), (ii) and (C) (mandatory and optional Medicaid coverage groups)
- 42 U.S.C. § 1396a(e)(14) (ACA application of MAGI to Medicaid)
- 42 U.S.C. § 1397bb(b)(1)(B)(v) (ACA application of MAGI to CHIP)
- 26 I.R.C. § 36B (MAGI application to Marketplaces)
- 26 I.R.C. § 151 (allowance of deductions for personal exemptions)
- 26 I.R.C. § 152 (coverage of dependents)
- 26 I.R.C. § 7703 (marriage definition)

3. Rulemaking

- Notice of Proposed Rulemaking - Medicaid Program; Eligibility Changes Under the Affordable Care Act of 2010; 76 Fed. Reg. 51148 (Aug. 17, 2011)

- Final Rule and Interim Final Rule - Medicaid Program; Eligibility Changes Under the Affordable Care Act of 2010, 77 Fed. Reg. 17144 (March 23, 2012)

[9] 42 U.S.C. § 1396d(y).

- Final Rule and Interim Final Rule - Establishment of Exchanges and Qualified Health Plans; Exchange Standards for Employers; 77 Fed. Reg. 18310 (March 27, 2012)

- Proposed Rule - Medicaid, Children's Health Insurance Programs, and Exchanges: Essential Health Benefits in Alternative Benefit Plans, Eligibility Notices, Fair Hearing and Appeal Processes for Medicaid and Exchange Eligibility Appeals and Other Provisions Related to Eligibility and Enrollment for Exchanges, Medicaid and CHIP, and Medicaid Premiums and Cost Sharing; 78 FR 4594 (Jan. 22, 2013)

- Final Rule - Medicaid and Children's Health Insurance Programs: Essential Health Benefits in Alternative Benefit Plans, Eligibility Notices, Fair Hearing and Appeal Processes, and Premiums and Cost Sharing; Exchanges: Eligibility and Enrollment; 78 FR 42160 (July 15, 2013)

4. Code of Federal Regulations

- 42 C.F.R. § 435.603 (Medicaid MAGI regulation)
- 42 C.F.R § 155.305 (Marketplace MAGI regulation)

II. Medicaid/CHIP Populations and Eligibility Categories Subject to or Exempted from MAGI

States must apply MAGI to many Medicaid populations and eligibility categories beginning in 2014. States may also implement MAGI for these population groups prior to 2014 through a § 1115 demonstration project.[10]

MAGI applies irrespective of whether the population is covered through the Medicaid state plan or through a waiver or demonstration project. MAGI applies regardless of whether a state expands Medicaid to include the new adult group.[11] MAGI applies to eligibility determinations for new applicants as well as recertifications. Some enrollees may lose Medicaid eligibility as a result of the loss of income disregards under MAGI. The ACA provides limited protection for persons who eligibility redeterminations are scheduled between January 1, 2014 and March 31, 2014 who lose eligibility solely due to the switch to MAGI.[12] Medicaid coverage for these individuals must continue until March 31, 2014 or the next regularly scheduled redetermination.[13]

However, there are some populations and eligibility categories to which MAGI does not apply. Moreover, the ACA prohibits HHS from waiving MAGI except in limited circumstances.

A. Populations and Eligibility Categories Subject to MAGI

1. Newly eligible adults

MAGI applies to adults made newly eligible as a result of the ACA.[14] The ACA expands Medicaid in 2014 to cover all non-disabled, non-pregnant adults below age 65 with incomes up to 133% of the Federal Poverty Level (FPL).[15] Beginning in January 2014, an adult qualifies for Medicaid with income up to $15,856 a year.[16]

While the ACA expansion is a mandatory provision of the Medicaid Act, the Supreme Court ruled that CMS cannot compel states to implement the new eligibility, in effect

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[10] CMS, *Dear State Health Official & State Medicaid Director Letter* (May 17, 2013), at 3 (Facilitating Medicaid and CHIP Enrollment and Renewal in 2014).
[11] *Id.*
[12] 42 U.S.C. § 1396a(e)(14)(D)(v). *See* Section VII of this Guide for further discussion on state options for the transition to MAGI.
[13] *Id.* CMS regulations also delay applicability of MAGI for eligibility redeterminations scheduled before December 31, 2013. *See* 42 C.F.R. § 435.603(a)(3).
[14] For a discussion of this eligibility group, *see* NHeLP, *The Advocate's Guide to the Medicaid Program,* 3.3 (May, 2011) (all references to the Medicaid Guide hereinafter are to the May 2011 edition).
[15] 42 U.S.C. § 1396a(a)(10)(A)(i)(VIII). The statute provides for coverage up to 133% of the FPL, but with the 5% income disregard used to calculate income under the MAGI methodology, the limit is effectively 138%. *See* Section III.G. of this Guide for an explanation of the 5% disregard.
[16] This is based on the FPL for 2013. States will use the FPL in effect for 2013 until the new calculations for the Federal Poverty Level are released in January 2014.

allowing states to opt out of the adult Medicaid expansion.[17] States that do not take up the adult expansion must still implement MAGI for other applicable eligibility categories.

The ACA allowed states to expand Medicaid coverage to childless adults before 2014 by amending their state plans.[18] Connecticut, Minnesota, and the District of Columbia are the only early expansion states. These states will have to implement MAGI methodologies for the adult expansion group by January 2014.

2. Pregnant women

MAGI applies to all pregnancy-related Medicaid eligibility categories. States must provide full Medicaid coverage to pregnant women who meet the income and family composition rules that applied to the state's Aid to Families with Dependent Children (AFDC) program on July 16, 1996 (AFDC-96). If a pregnant woman's household income exceeds the AFDC-96 limit, but is at or below 133% of the FPL (or up to 185% of the FPL, at state option), she is entitled to Medicaid coverage of "pregnancy-related services" during pregnancy and the 60-day post-partum period.[19]

Notably, while not directly affecting MAGI, HHS rulemaking recently simplified and consolidated eligibility for pregnant women in the myriad of statutory eligibility categories, including qualified pregnant women,[20] poverty-level related pregnant women,[21] and institutionalized pregnant women.[22] All mandatory pregnancy categories are now described under the rule at 42 C.F.R. § 435.116.

a) Pregnancy coverage for individuals under 21

Prior to 2014, Medicaid eligibility for pregnant minors is decided under the same rules used for adults. States consider the family income of a minor child, including parental income. States can use less restrictive income and resource methodologies.[23] Thus, a state can disregard a parent's income to make the pregnant teen eligible on her own.

Beginning in 2014 under MAGI, the income of every household member must be counted, and states will no longer be able to apply selective income disregards.[24] The loss of these income disregards could render some pregnant minors financially ineligible for Medicaid, if pregnancy is their only pathway to coverage.

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[17] *NFIB v. Sebelius*, 132 S. Ct. 2566, 2607 (2012). For additional discussion, *see* Jane Perkins et al., *Summary & Analysis of the ACA Supreme Court Decision*, NHeLP, June 29, 2012, *available at* http://www.healthlaw.org/index.php?option=com_content&view=article&id=695:nhelp-summary-a-analysis-of-the-aca-supreme-court-decision&catid=37:news-a-alerts&Itemid=123.
[18] 42 U.S.C. § 1396a(k)(2).
[19] 42 U.S.C. §§ 1396a(e)(5)-(6).
[20] 42 U.S.C. §§ 1396a(a)(1)(A)(i)(IV),1396a(a)(1)(A)(ii)(IX).
[21] 42 U.S.C. § 1396a(a)(10)(A)(ii)(I).
[22] 42 U.S.C. § 1396a(a)(10)(ii)(IV).
[23] 42 U.S.C. § 1396a(r)(2)(A).
[24] 42 U.S.C. § 1396a(e)(14)(B).

CMS has taken steps to avoid this loss of coverage. Federal guidance allows states to preserve pregnancy coverage for minors by using an existing regulatory provision to create "reasonable classifications" of persons under age 21. The guidance outlines a two-part State Plan Amendment (SPA) whereby states can, in effect, grandfather the parental income disregard after 2014.[25] First, a state must establish a "reasonable classification" of pregnant individuals under age 21 (or under age 18, 19, or 20), as authorized under existing Medicaid regulations.[26] Second, a state must disregard *all income* for this population pursuant to § 1396a(r)(2)(A). Finally, the state then calculates a MAGI-equivalent income threshold based upon a 100% "block income disregard."[27] (*See* Section VI of this Guide for an explanation of conversion of current income thresholds for MAGI). The net result would be no income test at all.

3. Parents and caretaker relatives

States must provide Medicaid coverage to low-income parents and caregivers. Caretaker relatives can include parents, grandparents, siblings or other relatives.[28] Those eligible under this category are commonly referred to as the "Section 1931 group" after the section of the Social Security Act that provides for the eligibility.[29] MAGI methodologies apply to parents and caretaker relatives beginning in 2014.

States must convert their § 1931 income eligibility thresholds, based on AFDC and state-level income disregards, to a MAGI-equivalent eligibility standard. Under § 1931, states have a range from which to select the state's eligibility income threshold. The § 1931 federal minimum is the state's May 1, 1988 AFDC payment standards by family size. Therefore, states must convert to a MAGI equivalent the current threshold as well as the statutory minimum and maximum the state can choose for the § 1931 group. Under the ACA's Maintenance of Effort provision, states may not impose more restrictive eligibility standards on adult groups until 2014.[30] After January 1, 2014, a state may seek to limit eligibility under the § 1931 category by lowering the eligibility threshold, but can go no lower than the minimum standard allowed. See the discussion in Section VI for further information on the MAGI conversion.

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[25] CMS, *Answers to Frequently Asked Questions: Telephonic Applications, Medicaid and CHIP Eligibility Policy and 75/25 Federal Matching Rate* (Aug. 9, 2013), at 5.
[26] 42 C.F.R. § 435.222. The pre-print SPAs provided by CMS include the option to disregard 100% of the income of other vulnerable youth populations, such as children in state foster care, who are also subject to mandatory MAGI. *See* CMS State Plan Amendment Repository, Form S52, Eligibility Groups - Options for Coverage Reasonable Classification of Individuals under Age 21, available at http://medicaid.gov/State-Resource-Center/Medicaid-and-CHIP-Program-Portal/Medicaid-and-CHIP-PDF-Repository.html.
[27] CMS, *Dear State Health Official & State Medicaid Director Letter* (Dec. 28, 2012) (Conversion of Net Income Standards to MAGI Equivalent Income Standards).
[28] 42 U.S.C. §§ 1396a(a)(10)(i)(I), 1396u-1(a).
[29] *See* NHeLP, *The Advocate's Guide to the Medicaid Program*, 3.4.
[30] 42 U.S.C. § 1396a(gg).

4. Children

States must provide Medicaid to children age 1-6 with family income up to 133% FPL and to children age 6-19 with family income up to 100% FPL.[31] The ACA extends Medicaid coverage to all children younger than age 19 in families at or below 133% FPL.[32] States have the option to cover additional groups of children whose incomes exceed these levels.[33] Beginning in 2014, states will apply MAGI income counting methodologies to determine Medicaid eligibility for most of these children.[34]

a) Independent foster care adolescents

Since 2000, states have the option to provide Medicaid coverage to young adults known as "Independent Foster Care Adolescents."[35] Sometimes referred to as the "Chafee option," this provision permits states to cover individuals who are under age 21 (or at state option under 20 or 19) and were in foster care under the responsibility of the state on their 18th birthday, or any reasonable classification of those individuals.[36] States may, but are not required to, establish income limits for this coverage.[37] For states that have established an income limit, proposed federal rules require a conversion to a MAGI based standard.[38] Note, however, that many young adults who are eligible for this coverage may also be eligible for coverage as a former foster youth, which does not require a MAGI determination (see Section II.B.2.c of this Guide for a discussion of the new mandatory category for former foster youth).[39]

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[31] *See* NHeLP, *The Advocate's Guide to the Medicaid Program*, 3.4.
[32] 42 U.S.C. § 1396a(l)(2)(C).
[33] 42 U.S.C. §§ 1396a(a)(10)(A)(ii)(IX), 1396a(l)(1)(A)-(B).
[34] The ACA's Maintenance of Effort (MOE) provision prevents states from adopting more restrictive eligibility standards until 2014 for adults and 2019 for children. 42 U.S.C. § 1396a(gg). Although some children may lose eligibility due to the loss of income disregards under MAGI, CMS has determined that the MAGI conversion process satisfies the MOE requirement. *See* CMS, *Dear State Health Official & State Medicaid Director Letter* (Dec. 28, 2012), at 2 (Conversion of Net Income Standards to MAGI Equivalent Income Standards).
[35] 42 U.S.C. § 1396a(a)(10)(A)(ii)(XVII).
[36] 42 U.S.C. §§ 1396a(a)(10)(A)(ii)(XVII), 1396d(w).
[37] 42 U.S.C. § 1396d(w)(1)C).
[38] Medicaid, CHIP, and Exchanges: Essential Health Benefits in Alternative Benefit Plans, Eligibility Notices, Fair Hearing and Appeal Processes for Medicaid and Exchange Eligibility Appeals and Other Provisions Related to Eligibility and Enrollment for Exchanges, Medicaid and CHIP, and Medicaid Premiums and Cost Sharing, 78 Fed. Reg. 4594, 4689 (proposed Jan. 22, 2013) (to be codified at 42 C.F.R. § 435.226). Few states have opted to impose income limits for this population. Michael R. Pergamit et al., *Providing Medicaid to Youth Formerly in Foster Care Under the Chafee Option*, Urban Institute for the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Evaluation (Nov. 2012), at 5.
[39] The main differences in eligibility criteria are, 1) the Chafee option does not require that the youth have been enrolled in Medicaid while in foster care, and 2) the Chafee option provides coverage to age 21 rather than 26.

b) Children receiving state funded (non-IV-E) foster care, kinship guardianship assistance, or adoption assistance

States provide foster care and adoption assistance benefits with state and/or local funds for children who do not meet federal Title IV-E eligibility criteria and can use optional Medicaid categories to cover these children.[40] States may disregard income for these classifications of children.[41] However, states that have established an income test for this coverage will have to convert the income limits it to a MAGI based standard.[42] When MAGI takes effect in 2014, some children may lose eligibility due to the loss of income disregards.

Accordingly, CMS allows states to avoid cutting eligibility for these children. First, a state must establish a "reasonable classification" of the state foster or adoption assistance children as authorized under existing Medicaid regulations.[43] Second, a state must disregard *all income* for this population pursuant to § 1396a(r)(2)(A). Third, the state then calculates a MAGI-equivalent income threshold based upon a 100% "block income disregard."[44] The net result would be no income test at all. By adopting a 100% income disregard for this population before the switch to MAGI, states can preserve existing disregards that allow children in state foster care and adoption agreements to retain Medicaid eligibility if the state applies an income test to determine eligibility.

MAGI does not apply where states do not consider income at all when determining eligibility of children in state foster care, adoption assistance, and kinship guardian assistance. According to CMS, "[k]ey to the application of the MAGI exception to such children is whether the State Medicaid agency is required to make a determination of income for a child in foster care to determine eligibility for Medicaid. The precise legal or custodial status of the child in relationship to the State is not material."[45]

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[40] 42 U.S.C. § 1396a(a)(10)(A)(ii); 42 C.F.R. §435.222. Federal law provides a specific option for children with non-IV-E adoption assistance. 42 U.S.C. § 1396a(a)(10)(ii)(VIII); 42 C.F.R. § 435.227. Children who receive non-IV-E benefits can also be covered as medically needy. For a discussion of these options, *see* Evelyne P. Baumrucker *et al.*, Cong. Research Serv., R42378, *Child Welfare: Health Care Needs of Children in Foster Care and Related Federal Issues*, 18-24 (2012). See Section II.B.1.b of this Guide for a discussion of children who receive IV-E benefits.

[41] 42 U.S.C. § 1396a(r)(2).

[42] *See* 78 Fed. Reg. at 4689.

[43]§ 42 C.F.R. 435.222. State Plan Amendments proposed to implement MAGI methodologies for applicable categories allow the disregard of all income for this category. *See* CMS, Form S52, *Eligibility Groups - Options for Coverage Reasonable Classification of Individuals under Age 21*, available at http://medicaid.gov/State-Resource-Center/Medicaid-and-CHIP-Program-Portal/Medicaid-and-CHIP-PDF-Repository.html.

[44] CMS, *Dear State Health Official & State Medicaid Director* (Dec. 28, 2012) (Conversion of Net Income Standards to MAGI Equivalent Income Standards).

[45] Medicaid Program; Eligibility Changes Under the Affordable Care Act of 2010, 77 Fed. Reg. 17144, 17158 (proposed Mar. 23, 2012) (to be codified at § 435.603(j)(1)).

c) CHIP

The CHIP program provides health coverage to children from higher income families who are not eligible for Medicaid.[46] Beginning in 2014, MAGI applies to CHIP eligibility determinations.[47]

CHILDREN ARE PROTECTED: Children who lose Medicaid eligibility as a result of MAGI will be eligible for CHIP in most cases. However, the ACA protects children who are not otherwise eligible for an existing Medicaid category by requiring states to enroll them in a separate CHIP program.[48] CMS guidance outlines options available to states in implementing this coverage protection for children.[49]

5. Limited scope Medicaid – TB

States have the option to provide limited-scope Medicaid services to treat individuals infected with tuberculosis.[50] Eligibility for the TB category follows Supplemental Security Income (SSI) calculations.[51] It is not expressly exempt from MAGI. While CMS has acknowledged that the TB category could fall under the MAGI exemption for persons who qualify for Medicaid on the basis of being blind or disabled, it has indicated that it favors applying MAGI to the TB category.[52]

6. Family Planning

States can provide limited-scope family planning services to individuals at higher incomes either as a § 1115 demonstration project or through a state plan amendment.[53] Currently, 31 states have family planning expansions.[54] Beginning in 2014, MAGI rules will apply to limited-scope family planning services offered through either a state plan

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[46] 42 U.S.C. § 1397aa-mm.
[47] 42 U.S.C. §§ 1397bb(b)(1)(B)(v),1396a(e)(14)(A); 42 C.F.R § 457.315(a).
[48] 42 U.S.C. § 1397jj (note); Patient Protection and Affordable Care Act, Pub. L. No. 111–148, § 2101(f), 124 Stat. 119, 287-88 (2010).
[49] CMS, *Answers to Frequently Asked Questions: Medicaid/CHIP Affordable Care Act Implementation* (Apr. 25, 2013), at 2-4.
[50] 42 U.S.C. § 1396a(z).
[51] CMCS Informational Bulletin, *State Option to Enroll Tuberculosis (TB) Infected Individuals into the Medicaid Program* (June 16, 2011).
[52] 78 Fed. Reg. at 4610 (citing the exception at 42 U.S.C. § 1396a(e)(14)(D)(i)(III)). The pre-print state plan amendments to implement ACA provisions and revised regulations apply MAGI to the TB category, even though the regulations are not yet final. *See* CMS, *Medicaid & CHIP PDF Repository* (Oct. 2013), http://medicaid.gov/State-Resource-Center/Medicaid-and-CHIP-Program-Portal/Medicaid-and-CHIP-PDF-Repository.html.
[53] 42 U.S.C. § 1396a(a)(10)(A)(ii)(XXI); 42 U.S.C. § 1396a(ii); 42 U.S.C. § 1396a(a)(10)(G)(XVI) (there are two subclause XVIs, the first of which deals with family planning).
[54] Guttmacher Institute, *State Policies in Brief, Medicaid Family Planning Eligibility Expansions* (Oct. 1, 2013)) available at https://www.guttmacher.org/statecenter/spibs/spib_SMFPE.pdf.

amendment or § 1115 demonstration.[55] The conversion to the MAGI rules may result in a loss of coverage for individuals who are losing the income disregards that have previously been applied when determining eligibility.

There are options available to states to ameliorate the loss in coverage. For family planning programs offered under a state plan amendment, the ACA provides states the option to consider only the income of the individual applying for family planning benefits, instead of that of the entire household.[56] In addition, states can employ eligibility rules applicable to pregnancy-related services when determining eligibility for limited scope family planning services, including counting a pregnant applicant as a household of two.[57] Under proposed rules, states can consider only the applicant when determining the household composition, can consider only the applicant's income when determining household income, and may increase the family size by one.[58]

RESOURCE: For a quick reference guide to MAGI populations, please see the chart in Appendix A – **Medicaid Eligibility Categories and Populations Subject to MAGI.**

B. Populations and Eligibility Categories Not Subject to MAGI

The ACA requires states to use MAGI methodologies when making income determinations "notwithstanding [...] any other provision" of the Medicaid Act, unless the individual is expressly exempted. It also limits HHS' authority to waive MAGI except in limited circumstances. The exceptions to MAGI generally fall into three at-times overlapping categories:

- Eligibility categories and populations expressly exempt from MAGI;
- Categories where the state does not conduct an income determination; and
- Medicaid categories where eligibility does not depend on income.

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[55] 78 Fed. Reg. at 4605.
[56] 42 U.S.C. § 1396a(ii)(3).
[57] CMS, *Dear State Health Official & State Medicaid Director Letter* (July 2, 2010), at 2 (Family Planning Services Option and New Benefit Rules for Benchmark Plans).
[58] 78 Fed. Reg. 4592 (proposed Jan. 22, 2013) (to be codified at 42 C.F.R. § 435.603(k)). The pre-print state plan amendments implement this provision even though the regulations are not yet final. *See* CMS, *Medicaid & CHIP PDF Repository* (Oct. 2013), http://medicaid.gov/State-Resource-Center/Medicaid-and-CHIP-Program-Portal/Medicaid-and-CHIP-PDF-Repository.html.

1. Eligibility categories and populations exempt from MAGI

The ACA exempts highly vulnerable Medicaid eligibility categories and populations from MAGI.[59] These include persons eligible on the basis of disability, elderly, and blind individuals, as well as Medicaid's cost sharing supports for Medicare enrollees

a) Aged, Blind, and Disabled (ABD)

MAGI methodologies do not apply to Aged, Blind, and Disabled Medicaid eligibility categories.[60] These categories include: persons receiving mandatory state supplement payments, institutionalized individuals, disabled adult children, certain groups of working disabled individuals, and others.[61]

Notably, if an individual who is aged, blind, or disabled seeks Medicaid eligibility in a category where MAGI does apply, then the state Medicaid agency will use MAGI methodologies to determine income.[62] An example of this would be when a person who is 65 or older applies for Medicaid as a parent or caretaker relative. Even though the individual is old enough to be exempt from MAGI, their eligibility in this situation can be determined under the parent/caretaker relative category using MAGI rules. However, the state Medicaid agency should also conduct an eligibility determination for such individuals on a basis other than MAGI.

i. SSI recipients

In most states, individuals who qualify for Supplemental Security Income (SSI) automatically qualify for Medicaid.[63] These populations are expressly exempt from MAGI because states that accept SSI for Medicaid do not conduct an income-eligibility determination.[64]

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[59] 42 U.S.C. § 1396a(e)(14)(D).
[60] *Id.*
[61] For a comprehensive listing of ABD eligibility categories, *see* NHeLP, *The Advocates Guide to Medicaid*, 3.6 – 3.10.
[62] 42 C.F.R. § 435.603(j)(2-4).
[63] 42 U.S.C. § 1396a(a)(10)(A)(i)(II)(aa); 42 C.F.R. § 435.120.
[64] 42 U.S.C. § 1396a(e)(14)(A).

SSDI: Some persons with disabilities who do not qualify for SSI because of their income and assets may be eligible for SSDI. Unlike SSI, SSDI recipients are not automatically eligible for Medicaid. However, SSDI recipients may be eligible for Medicaid under another ABD category, and will automatically become enrolled in Medicare two years after their SSDI determination. In the interim, some of these individuals may be eligible for Medicaid under a MAGI-based category, such as the new adult expansion, or as Medically Needy (see discussion in Section II.B.1.g below). Once an SSDI recipient becomes eligible for Medicare, that individual will no longer be qualified for the adult Medicaid expansion. He or she may, however, be able to qualify for Medicaid under an aged, blind or disabled category or for a program where Medicaid pays for Medicare cost-sharing (see Section II.B.1.d of this Guide).

ii. Section 209(b)

Section "209(b) states" (so called after the Social Security Act provision authorizing the option) have elected to use more restrictive requirements than SSI for deciding who qualified for Medicaid. In 209(b) states, an SSI recipient does not automatically qualify for Medicaid.[65] There are currently eleven 209(b) states: Connecticut, Hawaii, Illinois, Indiana, Minnesota, Missouri, New Hampshire, North Dakota, Ohio, Oklahoma, and Virginia.[66] In 2014, 209(b) states may continue to employ their more restrictive income and resource methodologies.[67]

b) Children receiving Title IV-E and certain non IV-E foster care, adoption assistance or kinship guardianship assistance

Title IV-E provides federal financial participation in foster care, adoption assistance, and kinship guardianship assistance expenditure for children who meet federal eligibility criteria. These children are also categorically eligible for Medicaid.[68] There is no income test for these children; therefore they are not subject to MAGI.

Additionally, some states have chosen to disregard all income for children who receive non-IV-E foster care, kinship guardianship assistance, or adoption assistance.[69] Accordingly, these eligibility determinations are not subject to MAGI.

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[65] 42 U.S.C. § 1396a(f); 42 C.F.R. § 435.121. This option was created by Pub. L. No. 92-603, § 209(b).
[66] See NHeLP, *The Advocates Guide to Medicaid*, 3.7, note 57.
[67] 42 U.S.C. § 1396a(e)(14)(D)(i)(III).
[68] 42 U.S.C. §§ 1396a(a)(10)(A)(i)(I), 673(b)(3).
[69] *See* Section II.A.4.b of this Guide.

c) Katie Beckett option

A child with a disability receiving care in an institution (such as a hospital or nursing home) may qualify for SSI and Medicaid by counting only the child's income, and not the income and assets of the child's parents.[70] States have the option (often called the Katie Beckett option) to provide Medicaid to disabled children living at home who do not qualify for SSI or state supplemental payments due to their parent's income or resources.[71]

States may exercise this option if: 1) the child would qualify for Medicaid if he or she were in a medical institution; 2) the child requires hospital or nursing home level of care; 3) the home care is medically appropriate; and 4) the cost of home care would not exceed the cost of appropriate institutional care.[72]

Eligibility under this option is expressly exempt from MAGI rules.[73]

d) Individuals for whom Medicaid is paying Medicare cost-sharing

Medicaid will pay premiums and certain other costs for qualified low income individuals enrolled in Medicare, the federal health program for persons 65 and older and those with disabilities.[74]

- Qualified Medicare Beneficiaries (QMBs) – states cover Medicare Part A and Part B premiums and pay deductibles and coinsurance costs for disabled or elderly individuals who have countable income at or below 100% FPL for a family of the size involved, and have resources that do not exceed twice the Supplemental Security Income (SSI) resource-eligibility standard.[75]

- Specified Low Income Medicare Beneficiaries (SLMBs) - states cover Medicare Part B premiums for individuals who have countable income from 101-120% of

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[70] 42 U.S.C. § 1382c(a)(3)(C); 20 C.F.R. §§ 416.1161a, 416.1204a, 416.1165(i).
[71] 42 U.S.C. § 1396a(e)(3); CMS, State Medicaid Manual §§ 3500.2, 3589. A child must qualify as disabled under 42 U.S.C. § 1382c(a) (the SSI definition). Children whose parents' income or resources would place them above SSI limits if they lived at home often would be eligible for SSI, and thus, Medicaid, if they were institutionalized. This is sometimes referred to as the "Katie Beckett" option, named after an institutionalized ventilator-dependent child who was unable to live at home, not because of medical reasons but because she would have been financially ineligible for Medicaid. *See* Cong. Research Serv. for the Comm. on Energy & Commerce, Comm. Print 100-AA, *Medicaid Source Book: Background Data and Analysis* 69 (1988). If states exercise this option, all such eligible children in the state qualify. For further information, *see* NHeLP, *The Advocates Guide to Medicaid*, 3.11.
[72] 42 U.S.C. § 1396a(e)(3).
[73] 42 U.S.C. § 1396a(e)(14)(D)(III).
[74] For a discussion of these Medicare-related programs, please see NHeLP, *The Advocates Guide to Medicaid*, 3.10.
[75] 42 U.S.C. § 1396d(p).

FPL, and whose resources do not exceed twice the SSI resource-eligibility standard.[76]

- Qualifying Individuals (QIs) - states provide payment of Medicare Part B premiums for individuals who have the same characteristics as QMBs except that their countable income is 121-135% of FPL.[77]

These categories are statutorily exempt from MAGI methodologies.[78]

e) Dually eligible individuals

The ACA provides that HHS may waive MAGI "to the extent necessary to permit a State to coordinate eligibility requirements for dual eligible individuals (as defined in section 1915(h)(2)(B)) under the State plan, under a waiver of the plan, under title XVIII, and individuals who require the level of care provided in a hospital, a nursing facility, or an intermediate care facility for the mentally retarded."[79]

To date, HHS has not issued guidance regarding how it might apply the MAGI exception for dually eligible individuals. However, it appears that most dually eligible individuals will fall under another MAGI excepted category, such as over 65, blind and disabled individuals, SSI recipients, and those seeking long term care services.

f) Long term care

The ACA exempts from MAGI determinations of eligibility "purposes of medical assistance for nursing facility services, a level of care in any institution equivalent to that of nursing facility services, home or community-based services . . ."[80] These include services available under a § 1115 demonstration waiver or state plan amendment under Section 1915.[81]

According to CMS, the exception "applies only in the case of individuals who request coverage for long-term care services and supports for the purpose of being evaluated for an *eligibility group for which meeting a level-of-care need is a condition of eligibility or under which long term care services are not covered for individuals determined eligible using MAGI-based financial methods are covered*."[82] In other words, the MAGI exception does not apply to persons to determine eligibility under a MAGI category,

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[76] 42 U.S.C. § 1396a(a)(10)(E)(iii).
[77] 42 U.S.C. § 1396u-3(b).
[78] 42 U.S.C. § 1396a(e)(14)(D)(i).
[79] 42 U.S.C. § 1396a(e)(14)(F).
[80] 42 U.S.C. § 1396a(e)(14)(D)(iv); 42 C.F.R. § 435.603(j)(4).
[81] 42 U.S.C. §§ 1396a(e)(14)(D)(iv), 1396n; 42 C.F.R. § 435.603(j)(4). *See also* NHeLP, *The Advocates Guide to Medicaid*, 2.6 - 2.9.
[82] 78 Fed. Reg. at 4626 (emphasis added).

such as children or pregnant women, who may then request long term services and supports.

g) Medically Needy and spend down populations

The ACA exempts the Medically Needy from the application of MAGI-based methodologies.[83] Thus, the standard rule is that existing financial eligibility methodologies will apply to the Medically Needy category.

However, in a proposed rulemaking on January 22, 2013, CMS proposed to allow states to apply MAGI-based methodologies to count the income for the following Medically Needy eligibility groups:

- Individuals under the age of 21;
- Pregnant women; or
- Parents/caretakers.[84]

Under the CMS-initiated requirement, MAGI for these Medically Needy groups would differ from typical MAGI-based methodologies in several ways. First, states would need to ensure that there is no inappropriate deeming of income from relatives who should not count as part of that individual's Medicaid household.[85] Also, the proposed Medically Needy MAGI-option rule references regulations specifically related to MAGI countable income, not the MAGI prohibition on asset tests.[86] Thus, the proposed rule does not appear to prohibit states from retaining an asset test for Medically Needy eligibility if they take up this MAGI option. Finally, in order to meet the ACA's Maintenance of Effort requirement, states applying the Medically Needy MAGI-option would need to ensure that the new methodology does not restrict "aggregate" eligibility for children (until 2019).[87] CMS proposes that states calculate an average of current disregards for Medically Needy children, such as expenses for childcare, and adjust current income standards to account for that average disregard.[88] This approach mimics, but does not explicitly reference, the MAGI-conversion methodology guidance described below at Section VI.[89]

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[83] 42 U.S.C. § 1396a(e)(14)(D)(i)(IV).
[84] 78 Fed. Reg. at 4692. This proposed regulation has not been adopted as final, and it is unclear whether any state has adopted this option.
[85] 42 CFR § 435.602.
[86] 78 Fed. Reg. at 4692. (Asset tests are forbidden by 42 U.S.C. § 1396a(e)(14)(C); 42 C.F.R. § 435.603(g)(1).
[87] 42 U.S.C. § 1396a(gg).
[88] 78 Fed. Reg. at 4612.
[89] States with Medically Needy or 209(b) spend down programs that include adults who may be eligible for Medicaid Expansion, such as parents and caretakers or pregnant women, may need to convert their 2009 income standard to establish a MAGI-converted threshold for receiving enhanced FMAP for newly eligible beneficiaries.

h) Express Lane Findings

The eligibility determinations of Express Lane Agencies are expressly exempt from MAGI.[90] In 2009, the Children's Health Insurance Program Reauthorization Act (CHIPRA) sought to facilitate enrollment of children by allowing state Medicaid and CHIP agencies to accept the eligibility findings of other, authorized agencies.[91] These may include means-tested programs such as Temporary Aid to Needy Families (TANF), the National School Lunch Program (NSLP), and the Supplemental Nutrition Assistance Program (SNAP).[92]

i) Medicare prescription drug subsidies

Low income Medicare recipients may qualify for assistance in purchasing prescription drugs through the Extra Help program, which provides up to $4000 in assistance for purchasing medications through the Medicare Part D program.[93] States have the option of conducting income determinations to qualify individuals for the Extra Help program.[94] The ACA expressly exempts state-level eligibility determinations for Extra Help from MAGI.[95] No state has yet exercised this option.

j) Limits on waivers

Section 1115 of the Social Security Act allows HHS to authorize "experimental, pilot or demonstration projects" which "are likely to assist in promoting the objectives" of the Medicaid Act.[96] Using this § 1115 authority, HHS may waive state plan requirements in 42 USC § 1396a.[97] However, the ACA requires MAGI to apply to all § 1115 demonstration projects for populations and eligibility groups subject to MAGI.[98] The ACA further prohibits HHS from waiving MAGI except in very limited circumstances.[99]

HHS may only waive MAGI to the "extent necessary to permit a State to coordinate eligibility requirements for dual eligible individuals."[100] To date, HHS has not issued guidance on how this waiver provision might be implemented. Moreover, it appears that most if not all of the individuals who would fall under this waiver provision are otherwise

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[90] 42 U.S.C. § 1396a(e)(14)(D)(ii).
[91] 42 U.S.C. § 1396a(e)(13)(A)(i).
[92] CMS, *Dear State Health Official & State Medicaid Director Letter* (Feb. 4, 2010), at 2 (Express Lane Eligibility Option).
[93] Social Security Administration, *Understanding the Extra Help with Your Medicare Prescription Drug Plan* (2013) *available at* http://www.ssa.gov/pubs/EN-05-10508.pdf.
[94] 42 U.S.C. § 1395w-114(a)(3)(B)(i).
[95] 42 U.S.C. § 1396a(e)(14)(D)(iii).
[96] 42 U.S.C. § 1315(a).
[97] 42 U.S.C. § 1315(a)(1).
[98] 42 U.S.C. § 1396a(e)(14)(A).
[99] 42 U.S.C. § 1396a(e)(14)(F).
[100] *Id.*

exempt from MAGI (e.g., as SSI recipients, people with disabilities eligible for home- and community based services through the state plan or waiver, or individuals over age 65).

The ACA contains a second waiver provision allowing HHS to waive Medicaid and CHIP provisions "as are necessary to ensure that States establish income and eligibility determination systems that protect beneficiaries."[101] HHS cites to this waiver authority in guidance allowing states to delay Medicaid eligibility recertifications scheduled for the first quarter of 2014.[102] The delay in recertification does not expressly exempt populations from MAGI, but allows states to avoid running two eligibility systems simultaneously while maintaining protections for individuals who might otherwise lose coverage resulting from the switch to MAGI during the transition period. HHS has given no further indication on use of this waiver authority.

RESOURCE: A chart of the ACA's express MAGI exceptions and their U.S. Code citations is in Appendix B - **ACA MAGI Exceptions.**

2. Categories subject to separate or no income counting rules

a) Early expansion

The ACA allows states the option to implement the adult Medicaid expansion through a state plan amendment prior to the 2014 effective date[103] According to guidance issued by CMS, states are not required to use MAGI for early expansions, but they are prohibited from using assets tests.[104] Rather, early expansion states must use reasonable income counting methodologies for this new group that are consistent with the objectives of the Medicaid program, simple to administer, and in the best interests of the beneficiary.[105] Only three states (Connecticut, District of Columbia, and Minnesota) expanded their Medicaid programs to childless adults using the ACA state plan option.[106] In January 2014, all these early expansion groups will transition to MAGI rules.

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[101] 42 U.S.C. § 1396a(e)(14)(A).
[102] CMS, *Dear State Health Official & State Medicaid Director Letter* (May 17, 2013), at 4 (Facilitating Medicaid and CHIP Enrollment and Renewal in 2014). *See also* Section VII.B of this Guide.
[103] 42 U.S.C. § 1396a(k)(2).
[104] CMS, *Dear State Health Official & State Medicaid Director Letter* (April 9, 2010), at 2 (New Option for Coverage of Individuals under Medicaid).
[105] *Id.* at 3.
[106] Kaiser Comm. on Medicaid and the Uninsured, *How is the Affordable Care Act Leading to Changes in Medicaid Today? State Adoption of Five New Options* (May 30, 2012), at 4, *available at* http://kaiserfamilyfoundation.files.wordpress.com/2013/01/8312.pdf. Another five states (California, Colorado, Missouri, New Jersey, and Washington state) received approval for early adult expansions using § 1115 demonstration project authority. *Id.*

b) Post-eligibility disregards of income and resources

When an individual has established eligibility for Medicaid coverage and is institutionalized, receiving home and community-based waiver services, or receiving hospice care, the state must disregard certain types of income and resources. These disregards include: a personal needs allowance (at least $30 per month) for clothing and other personal needs of the individual while in an institution;[107] the maintenance needs for family members if an institutionalized individual has a spouse at home;[108] reasonable amount toward the cost of medical and remedial care that is not covered by Medicare or third parties;[109] and SSI and State Supplementary Payments (SSPs).[110] The remainder is then applied toward the cost of care.[111] Post-eligibility disregards are not subject to MAGI.

c) Former foster youth

Under the ACA, states are required to extend Medicaid coverage to individuals who age-out of foster care until age 26, regardless of their income.[112] This new category for former foster youth is distinguishable from the "independent foster adolescents" group (discussed in Section II.A.4.a of this Guide). Although many of these young adults might have been eligible under the new adult Medicaid expansion, this coverage allows them to remain in the traditional Medicaid program will the full scope of benefits.[113]

d) Newborns of Medicaid-eligible mothers

MAGI does not apply to newborn infants born to Medicaid-eligible mothers. These infants are deemed to be Medicaid eligible for one year as long as the mother remains Medicaid-eligible and the infant remains part of the mother's household.[114] Deemed newborns remain continuously eligible for Medicaid under new rules.[115]

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[107] 42 U.S.C. §§ 1396a(a)(50), 1396a(q)(1)(A)(i), 1396r-5(d)(1)(A); 42 C.F.R. §§ 435.733(c)(1), 436.832(c)(1); CMS, State Medicaid Manual § 3703.2.
[108] 42 U.S.C. § 1396r-5(d)(1)(C); 42 C.F.R. §§ 435.725(c)(3), 435.733(c)(3), 435.832(c)(3) (institutionalized individuals); 42 C.F.R. §§ 435.726(c)(3), 435.735(c)(3) (individuals on home and community-based waivers).
[109] 42 U.S.C. §§ 1396a(r)(1)(A), 1396r-5(d)(1)(D); 42 C.F.R. §§ 435.725(c)(4), 435.733(c)(4), 435.832(c)(4) (institutionalized individuals); 42 C.F.R. §§ 435.726(c)(4), 435.735(c)(4) (individuals on home and community-based waivers).
[110] 42 U.S.C. § 1396a(o) (requiring disregard of SSI benefits paid under 42 U.S.C. § 1382(e)(1)(E)).
[111] 42 U.S.C. §§ 1396a(r), 1396a(o); 42 C.F.R. §§ 435.725, 435.733, 435.832, 436.832; CMS, State Medicaid Manual §§ 3584.2, 3590.9, 3700-3708.
[112] 42 U.S.C. § 1396a(a)(10)(A)(i)(IX).
[113] See CMS, *Medicaid and CHIP FAQs: Funding for the New Adult Group, Coverage of Former Foster Care Children and CHIP Financing,* Dec. 27, 2013, available at http://www.medicaid.gov/Federal-Policy-Guidance/downloads/FAQ-12-27-13-FMAP-Foster-Care-CHIP.pdf.
[114] 42 U.S.C. § 1396a(e)(4); 42 C.F.R. § 435.117 (revised in 78 Fed. Reg. at 4686).
[115] *Id.*

e) Breast and Cervical Cancer Treatment Program (BCCTP)

States may extend Medicaid coverage to low income, uninsured women screened for breast or cervical cancer by the Centers for Disease Control and Prevention (CDC).[116] There are no Medicaid income or resource limitations imposed by federal law for this Medicaid eligibility group.[117] Therefore, MAGI does not apply.

RESOURCE: For a chart showing the non-MAGI Medicaid eligibility categories and their citations in the Medicaid Act, please see Appendix C - **Populations and Eligibility Categories Where MAGI Does Not Apply.**

[116] CMS, *Dear State Health Official & State Medicaid Director Letter* (Jan. 4, 2001), at 2 (Overview of the National Breast and Cervical Cancer Early Detection Program and New Medicaid Coverage Option).
[117] 42 U.S.C. §§ 1396a(a)(10)(A)(ii)(XVIII), 1396a(aa).

III. Determination of Countable Income

A. General Principles

The primary building block for determining income for both Medicaid/CHIP and APTCs/CSRs is adjusted gross income (AGI) as defined under the Internal Revenue Code. AGI is then adjusted slightly to become "modified adjusted gross income" (MAGI).

The IRS/MAGI rules apply to all APTC/CSR applications. However, Medicaid/CHIP MAGI rules will diverge in some areas, as set forth below.

The most significant change from previous Medicaid income-counting rules is the elimination of the many possible deductions or income disregards: no disregard for earned income, no deduction for child support paid, no deduction for child care expenses (unless through a flexible spending account), etc. Instead, there is only a uniform 5% FPL disregard applied to MAGI in situations where it would determine eligibility for Medicaid and CHIP.

REMINDER: Existing Medicaid income-counting rules will continue to apply for MAGI-exempt categories. Those rules are not covered in this manual. Refer to NHeLP's *The Advocate's Guide to the Medicaid Program* and your individual state's rules for income-counting rules for non-MAGI populations.

While the ACA's reliance on IRS rules may sound foreign and intimidating, the Single Streamlined Application that state agencies and Marketplaces must use should easily walk applicants and assisters through the process without requiring reference to IRS income tax schedules (see Section VIII for discussion of the Single Streamlined Application).

RESOURCE: If there is a question about a particular type of income, reference to IRS Form 1040, and the Form 1040 Instructions, can be a helpful guide. For reference, we include Form 1040 as Appendix D, also available at: http://www.irs.gov/pub/irs-pdf/f1040.pdf. Form 1040 Instructions can be found at: http://www.irs.gov/pub/irs-pdf/i1040gi.pdf.

It is also important to keep in mind that, while eligibility for APTCs/CSRs is calculated based on annual income, Medicaid/CHIP eligibility for applicants will still be based on current monthly income, i.e., "point in time," even in MAGI methodologies (See discussion below Section III.F). The Single Streamlined Application will allow the applicant to report income based on the most convenient time period (e.g., hourly, weekly, monthly, etc.). The computer system (known as the "MAGI Rules Engine") will

do the necessary calculations to translate reported income into the appropriate time frame for the eligibility determination.

NOTE: This section of the Guide only addresses what income is to be included, not whose income is included. Please refer to Section IV "Household Composition" to determine whether or not the income of a particular family member is to be included in the income calculation.

B. Adjusted Gross Income

The starting point for calculation of income is the amount of Adjusted Gross Income (AGI) reported on Line 37 of IRS Form 1040, U.S. Individual Income Tax Return.

Form 1040 calculates AGI in two major steps. First, the tax filer lists various types of income on Lines 7 through 21, and then combines them on Line 22 as Total Income. Next, the filer calculates various expenses and pre-tax, or "above the line," deductions on Lines 23 through 35. These amounts are totaled on line 36, and then removed ("adjusted out" of) the total income, leaving AGI on Line 37.[118]

Any income not counted as income on lines 7 through 21 on Form 1040 will not be part of MAGI. Likewise, any "above the line" adjustments to income reported on Lines 23 through 35 will reduce the total MAGI income. IRS instructions for calculating Adjusted Gross Income are available at: http://www.irs.gov/pub/irs-pdf/i1040gi.pdf.

The following chart summarizes some of the most common types of income and adjustments for MAGI purposes that might be relevant for lower income persons. For the complete list, see the IRS documents referenced above.

Selected Income and Adjustments Included in AGI	
Type of Income	**Form 1040 Line**
Wages, salaries, tips (earned income)	Line 7
Interest and Dividends	Lines 8 and 9
State Income Tax Refunds	Line 10
Alimony Received	Line 11
Profit or Loss From Self-Employment (Schedule C)	Line 12
Rental Income	Line 17
Unemployment Compensation	Line 19
Social Security Benefit	Line 20a

[118] These adjustments differ from "below the line" deductions, such as mortgage interest or charitable donations, which are reported on Schedule A and removed further down on the tax return.

Selected Income and Adjustments Included in AGI	
Type of Adjustment (Reduction)	**Form 1040 Line**
Moving Expenses (Form 3903)	Line 26
Deductible part of self-employment tax	Line 27
Alimony Paid	Line 31a
Student Loan Interest Deduction	Line 33

For most applicants, whose sole income source is working for wages or a salary, the AGI (and the MAGI amount) will be taxable wages/salary as reported on Line 7 of Form 1040 and on Line 1 of the W2 (or a pay stub) (i.e., income *before* taxes). This should not differ from the gross income figure (prior to deductions or disregards) currently used to calculate an applicant's Medicaid eligibility. Besides wages/salaries, a number of other types of income will also be included in the AGI, such as self-employment income, various types of "unearned income," and state income tax refunds.

The following is a brief summary of specific types of income included in the AGI calculation for both APTCs/CSRs and Medicaid/CHIP.

1. Earned income

The term earned income means income from wages, tips and other forms of compensation. It is counted as gross income, i.e., income before taxes. This does not, however, include such items as retirement plan or cafeteria plan (a.k.a. flexible spending account) deductions, which are removed from taxable gross income. This is the amount that would be reported as "Wages, Tips, Other Compensation" in Box 1 on a W-2; it might be described with various labels on employer weekly, or other periodic, wage stubs.

NOTE: Tax withholding and other deductions will not be accounted for with an "earned income deduction" under MAGI.

2. Social Security

Only a portion of Social Security is subject to federal income tax and only that taxable portion is included in AGI under IRS income tax rules. However, under *Modified* Adjusted Gross Income, all Social Security income will be included.

3. Self-employment income

Unlike current Medicaid income counting rules that use the gross revenue received by a self-employed person (and then allow a deduction), the AGI generally counts only profit from a self-employed business (i.e. gross revenue minus expenses). Filers calculate such income using Schedule C of the U.S. Individual Income Tax Return.

RESOURCE: For detailed instructions, see IRS Instructions for Schedule C, Profit or Loss From Business: http://www.irs.gov/pub/irs-pdf/i1040sc.pdf. Notably, to obtain self-employment income, the model Single Streamlined Application only asks for "profits once business expenses are paid," without referring to things like amortization of capital assets.

4. Child support

Under MAGI, child support does not count towards the income of the family unit that includes the child receiving support. Rather, child support will count towards the income of the payor of child support, as there is no deduction for child support in the calculation of AGI.

NOTE: This differs from traditional Medicaid rules that count child support as income for the family unit that includes the child receiving the support.

5. Alimony

Unlike child support, alimony counts towards the AGI of the person who receives it. Thus, if a non-custodial, divorced parent pays alimony to the custodial parent, the amount of the alimony counts toward the AGI of the custodial parent, but "adjusts out" of the non-custodial parent's AGI. ("Alimony Received" must be reported as income on Line 11 of Form 1040, whereas "Alimony Paid" is adjusted out of income on Line 31a. On the Single Streamlined Application, Alimony Received is one of the specific types of income that must be reported.).

6. Veteran's benefits

Some veteran's benefits are not part of AGI, though such income would be considered as countable income under existing Medicaid rules. This rule excluding veteran's benefits from AGI applies to a variety of different Veteran's Benefits paid through the Veteran's Administration, including payments received as a service-related disability pension, annuity or similar allowance. However, military retirement pay that is based on age or years of service *is* taxable and will count toward MAGI.[119] Note that a service-

[119] *See* discussions on Military and on Disability Pensions in Chapter 5, Wages, Salaries and Other Earnings in IRS Publication 17 for a more detailed discussion of which types of veteran's and military benefits are taxable and which are not taxable. *See also* discussions on Military and on Military and Government Disability Pensions in IRS Publication 525, *Taxable and Nontaxable Income*. In addition to service-related disability pensions, certain other VA allowances, grants and other benefits are non-taxable.

related disability may be only "partial," designated by a percentage, so that a VA pension may be partially taxable and partially excludable from gross income.

C. From AGI to MAGI

Once Adjusted Gross Income (AGI) is defined and reported (see Line 37 of IRS Form 1040), *three adjustments* are made to AGI to transform it into *Modified* Adjusted Gross Income (MAGI).[120] These adjustments account for (1) foreign income, (2) tax exempt interest and (3) non-taxable Social Security benefits.

Few low income clients will have foreign income or tax-exempt interest, two of the ACA mandated "modifications" to the AGI. However, the modification that includes the non-taxable portion of Social Security benefits in MAGI will affect many applicants to insurance affordability programs. Advocates will not need to decipher what portion of Social Security is taxable and not taxable: *All* Social Security benefits (including retirement benefits, disability benefits, widow's benefits and survivors' benefits) are included in MAGI.[121]

AGI

+ Excluded Foreign Income

+ Tax Exempt Interest

+ Non-taxable Social Security benefits =

MAGI

D. Further Modifications to MAGI for Medicaid

For Medicaid eligibility determinations, a few additional types of income are excluded when determining MAGI that, by contrast, are included for APTCs/CSRs. These are:

1. Certain scholarship and fellowship income

Under IRS rules, certain types of educational scholarships and grants (for example, work-study arrangements and other situations in which the individual has to provide a service) are included in AGI. Current Medicaid rules exclude a broader scope of scholarships, awards or fellowship grants, and these rules are maintained for Medicaid MAGI.[122] The funds must still be used only for educational purposes (i.e., not living expenses), but such income can be excluded even if services were provided in return.

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[120] 26 I.R.C. § 36B(d)(2)(B); 42 C.F.R. § 435.603(e); 45 C.F.R § 155.305(f)(i).

[121] 26 I.R.C. § 36B(d)(2)(B)(iii). Under the federal tax rules, if an individual's only income is Social Security benefits, it is most likely that none of it will be taxable. If an individual has other income in addition to Social Security, then, depending on the amount of their income, a portion of the Social Security may be taxable. This must be calculated using a Worksheet in the Instructions to the Form 1040 or 1040A, but advocates will not need to know the details of such calculations since all Social Security will be counted for MAGI.

[122] 42 C.F.R. § 435.603(e)(2). *See also* 45 C.F.R. § 233.20.

2. Certain American Indian and Alaska Native income

While many types of AI/AN income are excluded from the federal tax and Section 36B definitions of MAGI (in some instances more liberally than current Medicaid rules), there are some forms of AI/AN income that count for IRS tax purposes but are excluded under current Medicaid income counting rules. These types of AI/AN income will continue to be excluded under Medicaid MAGI. For a list of the specific types of AI/AN income excluded under Medicaid MAGI, in addition to those types of income already excluded for IRS purposes, see 42 C.F.R. § 435.603(e)(3).

3. Lump sum income

In Medicaid, an amount received as a "lump sum" only counts as income in the month received. An example of a lump sum would be lottery winnings. Medicaid MAGI maintains the existing Medicaid rules, where lump sums are treated as income in the month received, and then as a resource in future months (even though resources are not part of the MAGI eligibility determination). This contrasts with the income determination for APTCs, where taxable lump sums count towards the tax filer's total AGI and would thus affect the amount of the APTC an applicant could receive in the calendar year.

NOTE: Gifts and Inheritances

Other common examples of "lump sums" are one-time gifts or inheritances. Gifts and inheritances are NOT included in MAGI (because gifts and inheritances are taxed to the donor or the estate, not to the receiver). Therefore, under MAGI rules for both Medicaid and APTCs, gifts and inheritances will not be counted at all.

E. Summary of Differences Between Current Medicaid Rules and MAGI

While MAGI income counting rules will now apply to most Medicaid eligibility categories (and to eligibility for CHIP, APTCs and CSRs), advocates will still need to know the current Medicaid rules for income counting. These will continue to apply to income calculations for non-MAGI Medicaid categories (*See* Section II.B). The following chart compares certain types of income that are treated differently under the two methodologies.

Income - Traditional Medicaid v. Medicaid/CHIP MAGI v. Marketplace			
Issue	**Traditional Medicaid[123]**	**Medicaid/CHIP MAGI**	**Marketplace MAGI**
Consider current monthly income or annual income?	Point-in-time income calculation based on current monthly income, with State option to consider predictable changes in income at initial determination.	Applicants: Current Month. Recipients: State option for current month or projected annual income for remainder of year. Applicants & Recipients: State option to adopt method to account for predictable decreases or increases in income.	Projected Annual Income
Social Security Benefits	Included as income	Included as income	Included as income
Child Support Received	Included (subject to small disregard)	Not included	Not included
Child Support Paid	Generally not included in income of payer under AFDC-related Medicaid	Included in taxpayer's income (taxable to person paying the child support)	Included in taxpayer's income (taxable to person paying the child support)
Alimony Received	Included in income	Included (taxable to person receiving alimony)	Included (taxable to person receiving alimony)
Alimony Paid	Not Included in income for AFDC-related Medicaid, but may be included for ABD Medicaid	Not included (not taxable to person paying alimony)	Not included (not taxable to person paying alimony)
Gifts and Inheritances	Treated as lump sum income; monetary gifts received regularly each month would be treated as income	Not included (gifts and inheritances are taxable to the donor or the estate, not to the person who receives them)	Not included (gifts and inheritances are taxable to the donor or the estate, not to the person who receives them)

[123] Note: These are general rules, subject to exceptions in particular situations, and which may vary by Medicaid category and by State.

Income - Traditional Medicaid v. Medicaid/CHIP MAGI v. Marketplace			
Issue	**Traditional Medicaid[123]**	**Medicaid/CHIP MAGI**	**Marketplace MAGI**
Veteran's Benefits Paid On the Basis of Service-Related Disability	Included as income	Not included as income	Not included as income
Scholarships, fellowship grants and awards used for education purposes	Excluded from income, including work-study income if used for educational costs	Excluded from income, including work-study income if used for educational costs	Excluded from income, but narrower definition than Medicaid rules (work-study income is taxable)
American Indian and Alaska Native (AI/AN) income derived from distributions, payments, ownership interests, and real property usage rights	Most types of AI/AN Income Excluded	Most of types of AI/AN Income Excluded	Some types of AI/AN Income Excluded, but narrower definition than Medicaid rules
Lump Sums Received (e.g., lottery winnings)	Included as income in month received; treated as resource in following months	Included as income in month received only	Included in annual income

F. Annual Income (Marketplaces) v. Point-in-time Income (Medicaid)

CMS regulations require states to determine Medicaid/CHIP eligibility for new applicants based upon their current monthly household income and family size.[124]

However, when conducting eligibility redeterminations for current Medicaid enrollees, states can opt to use either the current monthly household income and size or a projected annual household income and size for the remaining months of the calendar year.[125] The Medicaid and household size projection for the current calendar year may be different from the Marketplace projected household income and size, which requires the applicant to predict income and household size for the tax year.

States must also use "reasonable methods" when conducting income determinations based on either monthly or annual projected income. These "reasonable methods" include accounting for predictable increases or decreases in income, such as from

[124] 42 C.F.R. § 435.603(h)(1).
[125] 42 C.F.R. § 435.603(h)(2).

seasonal work, to help reduce churning resulting from fluctuations in income.[126] States can also use a prorated portion of income of a predictable change of income, and they can elect to use both methods.[127] States must indicate on its SPA implementing MAGI which income calculation it will use.

G. Disregards and Asset Test

One of the key changes under the Medicaid MAGI methodology is the elimination of various deductions and disregards currently applied to income for Medicaid and CHIP eligibility.[128] Instead, the ACA eliminated asset tests for MAGI categories and introduced a standard disregard of 5% FPL.[129] However, as explained below, this 5% FPL disregard is not used in all cases where MAGI applies.

NOTE: Deductions for Child Care Expenses

One of the most commonly used income deductions under current non-MAGI rules is child care expenses, for which federal rules require states to provide deductions of at least $175 per month ($200 per month for a child under age 2).[130] This deduction will no longer be allowable under MAGI rules. While IRS rules do allow a credit for child and dependent care expenses *(see* IRS Pub. 503), this credit is taken on Line 48 of Form 1040 and thus has no impact on reducing AGI. However, employees may be able to reduce their AGI for dependent care expenses if their employer provides for a qualified Flexible Spending Arrangement (FSA).[131] Income deposited into such an account is not included in wages on Line 7 of Form 1040 and thus will be excluded from AGI. This benefit is not available to self-employed persons.

1. Calculating the 5% FPL disregard

The simplest way to conceive of the new 5% disregard is to convert the individual's household income into an FPL percentage, subtract five FPL percentage points, and then, if necessary convert back to a dollar amount.[132] For example, if an individual's monthly income, calculated in accordance with MAGI rules, is 135% FPL, then the individual's income for Medicaid purposes would be 130%FPL. If the upper income limit for that individual's eligibility for Medicaid is 133% FPL, then the 5% FPL disregard will

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[126] 42 C.F.R. § 435.603(h)(3); 77 Fed. Reg. at 17157.
[127] *Id.*
[128] 42 U.S.C. § 1396a(e)(14)(B): "[N]o type of expense, block, or other income disregard shall be applied by a State to determine income eligibility for medical assistance under the State plan or under any waiver of such plan or for any other purpose applicable under the plan or waiver for which a determination of income is required"); *See also* 42 C.F.R. § 435.603(g)(2).
[129] 42 U.S.C. §§ 1396a(e)(14)(C), 1396a(e)(I)(1).
[130] 45 C.F.R. § 233.20(a)(11)(D).
[131] 26 U.S.C. § 129; 26 C.F.R. § 1.125-5(i).
[132] 42 C.F.R. § 435.603(d)(4).

render them eligible. This disregard explains the common reference that Medicaid expansion will go to 138% FPL.

2. Applying the 5% FPL disregard

a) Health Insurance Marketplaces

The 5% FPL disregard does *not* apply to eligibility determinations for APTCs/CSRs in the Health Insurance Marketplaces.

b) Medicaid and CHIP

While the statutory language might appear on its face to provide for application of the 5% FPL disregard in all income determinations for Medicaid and CHIP, CMS has determined that it will not apply in all cases. CMS has focused on the statutory directive that the 5% FPL disregard applies "[f]or purposes of *determining the income eligibility* of an individual for medical assistance…" [emphasis added.].[133] CMS interprets this to mean that the 5% disregard should apply *only* in situations where the individual would otherwise not be eligible for Medicaid, i.e., only when they are slightly above the highest FPL percentage that would make them eligible for Medicaid.[134]

EXAMPLE: Applying the 5% FPL Standard MAGI Disregard

George Michael lives in a state that has adopted the Medicaid expansion. The state's income threshold for § 1931 eligibility is 100% FPL. If George's MAGI income is 103% FPL, he would not qualify under § 1931 unless the 5% FPL disregard applied. However, George does qualify under the Medicaid expansion which provides eligibility up to 133% FPL. Because he would qualify for Medicaid under the adult expansion group, the 5% disregard will not apply to his MAGI income.

Eligibility determinations on a basis other than MAGI will continue to use existing deductions and disregards.

3. Elimination of Asset Test

In addition to the income counting rules, the ACA prohibits consideration of assets when determining MAGI-based eligibility.[135] Many states already disregard assets for children's eligibility, and nearly half the states have eliminated asset tests for parents

[133] 42 U.S.C. § 1396a(e)(14)(I).
[134] 42 C.F.R. §§ 435.603(d)(1), 435.603(d)(4). *See* discussion in the Preambles to the Proposed Rule at 78 Fed. Reg.4594, 4625-26 (Jan. 22, 2013) and to the Final Rule at 78 Fed. Reg. 42160, 42186-88 (July 15, 2013).
[135] *See* 42 C.F.R. § 435.603(g).

and caretakers. In those states that continued to use asset tests for those categories now subject to MAGI, a number of individuals stand to gain eligibility due to the elimination of asset tests. This change, which applies across all insurance affordability programs (for MAGI-based eligibility), also greatly simplifies the income determination and verification process.

IV. Household Composition - Marketplaces v. Medicaid/CHIP

A. Introduction

Eligibility for insurance affordability programs is based upon household income and family size. Generally, the total household income is the sum of MAGI income for all household members.[136] Income and family size together are then compared to the various eligibility thresholds, expressed as FPL percentages, to determine the program for which an individual qualifies, if any.

In the world of Medicaid and Marketplaces, a household is not necessarily the people you live with and are related to. Instead, the household is determined by the tax relationship among individuals, as well as their living arrangements, legal status, and other factors. Rules for determining who is in the "household" differ between the Marketplace and Medicaid.[137] The total number of individuals in the Marketplace or Medicaid household constitutes the family size.[138]

Therefore, eligibility and enrollment systems must conduct a person-by-person analysis for each individual seeking an eligibility determination for insurance affordability programs. This analysis applies Medicaid and Marketplace MAGI rules separately to determine who counts as a member of each individual's household for which program. This yields each individual's family size. While Marketplace family size and Medicaid family size will often be the same, because of differences in the rules, an individual's Marketplace family size may differ from the Medicaid family size.

Once an individual's MAGI household is clear, a second determination must be made as to whether or not to include the income of each household member in the calculation of total household income.

For Medicaid, CHIP and APTCs/CSRs, the general rule is that household income equals the sum of each member's MAGI. This might be just the income the tax filer expects to report on his or her tax return, but it might also include income from other household members whose income is not included on the tax filer's return.

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[136] 26 I.R.C. § 36B(d)(2).
[137] 26 I.R.C. § 36B; 42 C.F.R. § 435.603(b).
[138] Unlike in the Medicaid program, a pregnant woman cannot count as more than one person under IRS rules.

NOTE: There is a specific rule pertaining to the income of children who are claimed as dependents by their parents.[139] If the dependent child has enough income to *require* that the child file a tax return, then the income will be counted in the household.[140] For 2012, the minimum filing requirements for a dependent child are as follows:

- Unearned income, more than $1000
- Earned income, more than $6100
- Gross income, the larger of $1000 or earned income (up to $5750) plus $350.[141]

None of the child's income counts if the dependent child is not required to file, even if the dependent child chooses to file a separate tax return.[142]

A similar rule pertains to individuals other than a spouse or a child who expect to be claimed as a tax dependent. The income of such individuals will not count toward the household income of the tax filer if the dependent's income remains below the threshold requiring them to file a separate tax return, regardless of whether the dependent chooses to file his or her own tax return.[143]

EXAMPLE: Adult Dependents

If tax filer Joe claims his Aunt Betty as a dependent on his federal tax return because Aunt Betty lives with him and meets the requirements as a qualifying relative, Aunt Betty will nonetheless be in her own household for Medicaid purposes. Suppose that Joe, in addition to providing Aunt Betty room and board, also gives her $200 cash every month. States will have an option under Medicaid/CHIP MAGI to count the $200 given to her by Joe as part of Aunt Betty's monthly household income (assuming the State has defined $200 as more than nominal and that the family actually reports this to the Medicaid agency).

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[139] 42 C.F.R. § 435.603(d)(2)(i).
[140] *See* 26 I.R.C. § 6012(a)(1).
[141] *See* IRS, Publication 501, *Exemptions, Standard Deduction, and Filing Information for Use in Preparing 2013 Returns* (Dec. 3, 2013), *available at* http://www.irs.gov/pub/irs-pdf/i1040gi.pdf. The IRS publishes updated income filing requirements annually.
[142] The child may file a return in order to get a refund of taxes that were withheld, even if not required to file a return. Note that, as explained below, a person may file his own tax return and still be claimed as a dependent on someone else's return, if he meets the requirements as a qualifying child or qualifying relative.
[143] 42 C.F.R. § 435.603(d)(2)(ii).

Adult dependents will be in their own household under Medicaid MAGI rules. (They would, however, be part of the household of the tax filer who claims them as a dependent for APTCs/CSRs. *See* discussion of Marketplace household composition (family size) below). For Medicaid/CHIP determinations, states have an option to count any actually available cash support, exceeding nominal amounts, that is provided to such individuals by the person claiming them as a tax dependent.[144]

B. Family Size in the Marketplace

In the Marketplace, the family size will almost always be the same as the tax filer's household.[145] The Marketplace household is comprised of the tax filer(s) and those they expect to claim as dependents. A tax filer can be an individual or spouses (if filing jointly) who file federal income taxes *and* claim a personal exemption.[146]

In order to be claimed as a tax dependent, an individual must meet the requirements of either a "qualifying child" or a "qualifying relative" (explained in Section IV.B.4 below). Only one tax filer (or spouses filing jointly) can claim an individual as a dependent.[147] Tax filers may claim an exemption for a dependent, even if the dependent files his or her own federal tax return.[148]

Each individual counted as a member of the Marketplace household will have the same family size. Because APTC/CSRs are administered through the federal income tax system, they can be provided only to individuals and families who file or are claimed on federal income tax returns. Marketplace determinations for APTCs/CSRs and cost sharing assistance are forward-looking, based upon the projected household size and income for the tax year in which eligibility begins.

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[144] 42 C.F.R. § 435.603(d)(3).

[145] Individuals who are not lawfully present are not counted as members of a tax household. *See* 26 I.R.C. § 36B(e)(1)(B)(i)(I) *and* Section IV.B.9 of this Guide for a discussion of individuals who are not lawfully present.

[146] 26 I.R.C. §§ 151,152. *See generally* IRS, Publication 501, *Exemptions, Standard Deduction, and Filing Information for Use in Preparing 2013 Returns* (Dec. 3, 2013), *available at* http://www.irs.gov/pub/irs-pdf/i1040gi.pdf (tax rules that affect every person who may have to file a federal income tax return).

[147] *Id.*

[148] *Id.*

NOTE: Individuals who fall below certain income thresholds are not required to file federal income taxes (see the chart below). These individuals may not claim a personal exemption if they can be claimed as a dependent by another tax filer. The situation typically arises when a young adult is claimed by her parents as a dependent. If she works a summer job and has federal income taxes withheld, she may file her own federal income tax return to receive a tax refund. Since her parents claim her as a dependent, she may not take a personal exemption and thus would not be considered a "tax filer" for Marketplace or Medicaid MAGI purposes. Instead, she would count as a member of the tax filing household that claims her as a dependent.

Who Must File a Federal Income Tax Return[149]

IF your filing status is...	AND at the end of 2012 you were...*	THEN file a return if your gross income was at least...**
single	under 65	$10,000
	65 or older	$11,500
head of household	under 65	$12,850
	65 or older	$14,350
married, filing jointly***	under 65 (both spouses)	$20,000
	65 or older (one spouse)	$21,200
	65 or older (both spouses)	$22,400
married, filing separately	any age	$3,900
qualifying widow(er) with dependent child	under 65	$16,100
	65 or older	$17,300

* If you were born before January 2, 1948, you are considered to be 65 or older at the end of 2012.

**Gross income means all income you received in the form of money, goods, property, and services that is not exempt from tax, including any income from sources outside the United States or from the sale of your main home (even if you can exclude part or all of it). Do not include any social security benefits unless (a) you are married filing a separate return and you lived with your spouse at any time during 2012 or (b) one-half of your social security benefits plus your other gross income and any tax-exempt interest is more than $25,000 ($32,000 if married filing jointly). If (a) or (b) applies, see the Form 1040 instructions to figure the taxable part of social security benefits you must include in gross income. Gross income includes gains, but not losses, reported on Form 8949 or Schedule D. Gross income from a business means, for example, the amount on Schedule C, line 7, or Schedule F, line 9. But in figuring gross income, do not reduce your income by any losses, including any loss on Schedule C, line 7, or Schedule F, line 9.

*** If you did not live with your spouse at the end of 2012 (or on the date your spouse died) and your gross income was at least $3,800, you must file a return regardless of your age.

[149] IRS, Publication 501, *Exemptions, Standard Deduction, and Filing Information for Use in Preparing 2013 Returns* (Dec. 3, 2013), *available at* http://www.irs.gov/pub/irs-pdf/p501.pdf. For additional situations where someone must file a federal income tax return, *see* Publication 501 or consult with a tax attorney.

1. Married, separated, and divorced couples

Both individuals in a married couple filing a joint tax return are "tax filers;" one spouse does not claim the other as a dependent.[150] Under tax law, marital status is determined as of the close of the calendar year.[151] Married couples must file a joint tax return to receive APTCs/CSRs.[152] Couples who are separated, but not yet divorced, are still considered married, and therefore must, in most circumstances, file jointly to be eligible for APTCs/CSRs.[153]

NOTE: Under Medicaid MAGI rules, married couples who live together are counted in the same household regardless of whether they file joint or separate federal income tax returns (See discussion in Section IV.C.2.d of this Guide.)

Under the IRS code, persons who are divorced or a party to a "decree of separate maintenance" are unmarried. In some cases, state courts may render a final ruling on marital status, which renders the parties "unmarried" for tax purposes, but still retain jurisdiction to handle disputes about property or custody.[154] In regard to decrees of separate maintenance, IRS regulations and recent case law indicate that a written separation agreement between parties is not considered a "decree of separate maintenance" and that the decree of separation must be issued by a court.[155] Under certain circumstances, a married taxpayer separated from his/her spouse may be "considered unmarried," and thus not required to file jointly to qualify for APTCs/CSRs. To be "considered unmarried," an individual must meet the following requirements:

1. File a separate return
2. Pay more than half the cost of keeping up his/her home for the tax year.
3. Your spouse did not live in your home during the last 6 months of the tax year. (Your spouse is considered to live in your home even if he or she is temporarily absent due to special circumstances).

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[150] 26 I.R.C. § 36B(d)(1); 26 I.R.C. § 151; 26 I.R.C. § 152(b)(2).
[151] I.R.C. § 7703(a).
[152] 26 I.R.C. § 36B(c)(1)(C); 45 C.F.R. §§ 155.300, 155.310(d)(2)(ii)(B).
[153] See *Argyle v. Commissioner*, 397 Fed. Appx. 823 (3d Cir. 2010) (affirming tax court decision that living "separate and apart" does not confer single filing status).
[154] *See, e.g.,* California Family Code § 2337, which allows the court, in a dissolution proceeding, to have an early and separate trial on the dissolution of the status of the marriage, apart from other issues.
[155] 26 I.R.C. § 7703(a). A "decree of separate maintenance" is a rarely used legal status conferred by a court that in some states changes marital status. See *Boyer v. C.I.R.*, 732 F.2d 191, 194 (C.A.D.C.,1984) finding that "the proper inquiry is whether an order of separate maintenance affects marriage status in such a way that it is deemed a legal separation under applicable state law." *See also* 26 C.F.R. § 1.7703(a), example 1.

4. Your home was the main home of your child, stepchild, or foster child for more than half the year.
5. You must be able to claim an exemption for the child.[156]

Persons who are "considered unmarried" commonly use the tax filing status "Head of Household," which provides a lower tax rate and higher deduction than "married, filing separately" or "single."

The following are the requirements for filing as "Head of Household:"

1. The individual is unmarried or considered unmarried on the last day of the year;
2. Paid more than half the cost of keeping up a home for the year;
3. A qualifying person (child or relative) lived with you in the home for more than half the year (except for temporary absences, such as school). However, if the qualifying person is your dependent parent, he or she does not have to live with you.[157]

Individuals who meet the requirements for "considered unmarried" will also qualify for Head of Household filing and can be eligible for APTCs/CSRs even if the married couple does not file a joint federal income tax return.[158] However, the remaining spouse will not be treated as "unmarried," and thus not eligible for APTCs/CSRs, unless he/she separately meets the requirements to file as Head of Household.

In 2012 guidance, the IRS stated it will issue additional regulations to help address APTC/CSR eligibility in situations where married couples cannot file joint federal tax returns, such as estrangement which involves domestic abuse or spousal abandonment.[159] However, to date, no such regulations have been issued.

REPORTING CHANGES: Significant life changes such as marriage, divorce, birth, death, and changes in income must be reported to the Marketplace and may affect eligibility for APTCs/CSRs.

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[156] 26 I.R.C. § 7703(b). *See also* IRS, Publication 501, *Exemptions, Standard Deduction, and Filing Information for Use in Preparing 2013 Returns* (Dec. 3, 2013), available at http://www.irs.gov/pub/irs-pdf/p501.pdf.

[157] 26 I.R.C. § 7703(b). Maintaining a household includes paying for property taxes, mortgage interest, rent, utility charges, upkeep and repairs, property insurance, and food consumed on the premises. Such expenses do not include the cost of clothing, education, medical treatment, vacations, life insurance, and transportation. 26 C.F.R. § 1.7703-1(b)(4).

[158] See IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information for Use in Preparing 2013 Returns* (Dec. 3, 2013), available http://www.irs.gov/pub/irs-pdf/p501.pdf for additional information on alternate filing statuses available to married couples, including "married," "married, filing separately" and "head of household."

[159] Internal Revenue Bulletin: 2012-24, *Health Insurance Premium Tax Credit*, 4.c.ii (June 12, 2012) available at http://www.irs.gov/irb/2012-24_IRB/ar05.html#d0e558.

EXAMPLE – Al and Peggy are married with two children. Peggy lives with the children and pays more than one half of the costs for rent and food to provide them a home. Peggy and Al have lived apart for more than six months. Peggy, though still married to Al, is "considered unmarried" under the IRS definition. She files federal income taxes using the "head of household" filing status and claims the children as dependents. She is determined eligible for APTCs based upon her income and household size. However, Al is still considered married under the IRS definition, and must file his federal income taxes as "married, filing separately." He is therefore not eligible for APTCs/CSRs.

2. Same sex married couples

Same sex married couples are now permitted to file joint federal tax returns and are therefore able to receive APTCs and CSRs together if eligible. Recent guidance from the IRS establishes that same sex couples who were legally married in a state that permits same sex marriage are eligible to receive APTCs/CSRs, regardless of whether the state in which they reside recognizes their marriage.[160] Although same sex marriages are recognized for computing family size and household income, the guidance does not expressly require Qualified Health Plans to make family coverage available to same sex married couples.

NOTE: Although all state Marketplaces must recognize same sex marriages for APTC/CSR eligibility, under CMS guidance states have flexibility in deciding whether to recognize same sex marriage for Medicaid/CHIP eligibility. See Section IV.C.2.f of this Guide for further discussion of same sex marriage and Medicaid/CHIP.

3. Unmarried couples

Couples who are living together but who are not married may not file joint federal income tax returns, and they are therefore not eligible for APTCs as a single family unit. They may, however, file taxes separately and could be eligible for APTCs as individuals or as a household comprised of a single tax filer plus dependents. A tax filer could claim

[160] Rev. Rul. 13-17, 2013-38 I.R.B. 201 (Aug. 30, 2013), *available at* http://www.irs.gov/pub/irs-drop/rr-13-17.pdf (explaining that for federal income tax purposes, the IRS recognizes marriages based on the laws of the state in which they were entered into without regard to subsequent changes in domicile). *See also* Gary Cohen, CMS Deputy Administrator and Director, Center for Consumer Information and Insurance Oversight, *Guidance on Internal Revenue Ruling 2013-17 and Eligibility for Advance Payments of the Premium Tax Credit and Cost-Sharing Reductions* (Sept. 27, 2013), *available at* http://www.cms.gov/CCIIO/Resources/Regulations-and-Guidance/Downloads/marketplace-guidance-on-irs-2013-17.pdf.

his or her partner as a tax dependent if the income and other requirements for a "qualifying relative" are met (discussed below in Section IV.B.4.b).

4. Who is a dependent?

IRS rules govern who can be claimed as a dependent on an income tax return. A dependent can be a "qualifying child" or a "qualifying relative." One spouse may not claim another spouse as a dependent.[161] Under IRS rules, if a taxpayer claims an individual as a dependent, that individual cannot claim someone else as a dependent in that calendar year.[162] For example, if an 18 year old student who is claimed as a dependent on her parents' tax return has a baby, she cannot claim that baby as her dependent for that calendar year. However, her parents may claim the baby as a dependent on their tax return.

a) Qualifying child

The term "qualifying child" includes a biological child, adopted, step child, or an eligible foster child.[163] A child's descendant can also be a qualifying child and claimed as a dependent by a tax filer. However, the relationship to the tax filer is just one requirement to be a qualifying child. Any "qualifying child" must also:

- Be a US citizen or legal resident of the US, Canada, or Mexico;
- Live with the taxpayer for more than one-half of the taxable year;
- Be under age 19, or if a full-time student, age 24;
- Not provide more than one half of his or her own financial support during the taxable year (note this does not place a requirement on the tax filer's level of support for the child to claim that child as a dependent); and
- Not have filed a tax return with the tax filer's spouse.[164]

If a child's parents are married but separated and file separate tax returns, the child may be claimed as a dependent by the parent with whom the child resides for the longest period of time in a tax year.[165] If the child lives with both parents an equal amount of time in the tax year, the parent with the highest adjusted gross income can claim the child as a dependent.[166]

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[161] IRS, Publication 17, *Tax Guide 2012 for Individuals* (Jan. 31, 2013), at 27, *available at* http://www.irs.gov/pub/irs-pdf/p17.pdf.
[162] 26 I.R.C. § 152(b)(1).
[163] 26 I.R.C. §§ 152(c),(f).
[164] 26 I.R.C. §§ 152(c)(1)(A)-(E).
[165] 26 I.R.C. § 152(c)(4)(B)(i).
[166] 26 I.R.C. § 152(c)(4)(B)(ii).

NOTE: Child claimed by a non-custodial parent

Generally, the custodial parent in a divorced couple will claim any children as dependents. However, the IRS Code has a special rule for divorced parents that allows a non-custodial parent to claim a child as a dependent if certain conditions are met, including the agreement of the custodial parent.[167]

Tests to Be a Qualifying Child

- The child must be your son, daughter, stepchild, foster child, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them.
- The child must be (a) under age 19 at the end of the year and younger than you (or your spouse if filing jointly), (b) under age 24 at the end of the year, a student, and younger than you (or your spouse if filing jointly), or (c) any age if permanently and totally disabled.
- The child must have lived with you for more than half of the year.
- The child must not have provided more than half of his or her own support for the year.
- The child is not filing a joint return for the year (unless that joint return is filed only to claim a refund of withheld income tax or estimated tax paid).
- The child must be a U.S. citizen, U.S. resident alien, U.S. national, or a resident of Canada or Mexico (except for certain adopted children).

If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child.

b) Qualifying relative

A tax filer's child who is too old to be a "qualifying child" may nonetheless be claimed as a dependent as a "qualifying relative." The rules for qualifying relative resemble those for qualifying children in that they both define specific relationship and support parameters. To claim a "qualifying relative" as a dependent:

- The relative must be an offspring, parent, sibling, in-law, or other qualified relation, or living with the tax filer for the full year and a member of the household;

[167] 26 I.R.C. § 152(e).

- The relative must be a US citizen or legal resident of the US, Canada, or Mexico;
- The tax filer must provide more than one half of the relative's financial support;
- The relative's gross income must not exceed the exemption amount[168] ($3,900 for 2013).[169]

A qualifying relative need not be related to the tax filer at all, but must be living in the tax filer's household and meet the requirements for a "qualifying relative."[170]

Tests to Be a Qualifying Relative

- The person cannot be your qualifying child or the qualifying child of any other taxpayer.
- The person either (a) must be related to you in one of the ways listed under IRS rules (relatives do not have to live with you), or (b) must live with you all year as a member of your household (and your relationship must not violate local law).[171]
- The person's gross income for the year must be less than the exemption amount (currently $3,900).
- You must provide more than half of the person's total support for the year.[172]

5. Foster children

In most cases, foster children automatically qualify for Medicaid and will not need private insurance purchased through the Marketplace.[173] The ACA expressly exempts children in the federal foster care program under Title IV-E, from MAGI.[174] Such children are automatically eligible for Medicaid with no income test. The ACA also exempts

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[168] 26 I.R.C. § 152(d).
[169] IRS, *Annual Inflation Adjustments for 2013* (Jan. 11, 2013), *available at* http://www.irs.gov/uac/Newsroom/Annual-Inflation-Adjustments-for-2013.
[170] 26 I.R.C. § 152(d).
[171] *Id.* Relationships that may meet the criteria for a qualifying relative include: a child of the taxpayer or a descendent of a child of the taxpayer; a brother, sister, or step-sibling/in law of the taxpayer; a son, daughter, brother, or sister in law of the taxpayer; a niece, nephew, aunt, or uncle of the taxpayer; a father, mother, stepfather, stepmother, or father or mother in law of the taxpayer; or an individual who has the same place of abode and is a member of the taxpayer's household.
[172] There are exceptions for multiple support agreements, children of divorced or separated parents (or parents who live apart), and kidnapped children.
[173] 42 C.F.R. § 435.145.
[174] 42 U.S.C. § 1396a(e)(14)(D)(i)(I). *See also* Section II.B.1.b of this Guide.

children enrolled in state-only funded foster care if the state similarly makes those children automatically eligible for Medicaid.[175]

However, under IRS rules, a "qualifying child" can include a foster child placed in the tax filer's household by an authorized agency or by court decree.[176] As such, a tax filer can claim her foster child as a dependent if other requirements for a "qualifying child" or "relative" are met (e.g., living in the household for at least one half of the year). Thus, a foster child would be considered a member of the tax household for purposes of calculating the family's eligibility for APTCs/CSRs for plans purchased in the Marketplace.

EXAMPLE: Foster child joins the tax household

A family of four with a total income of $60,000 (255% FPL) qualifies for APTCs, but not cost sharing assistance which is limited to those making less than 250% FPL. If that family took in a foster child for at least six months and expected to claim the child as a dependent on the family's tax return, the family size would increase from 4 to 5 people, and their income as an FPL percentage would decrease to 218% FPL for a family of 5. As a result, the family would qualify for cost sharing subsidies and increased premium assistance, even if the foster child were enrolled in Medicaid.

Remember, an individual does not have to qualify for assistance in order to be counted as a member of the household.

6. Pregnant women

IRS rules do not allow unborn children to be claimed as tax dependents. Therefore, for purposes of calculating the Marketplace household size, a pregnant woman is counted as one person. However, Medicaid has special rules for counting pregnant women that include the number of babies expected (see discussion below). Thus, a pregnant woman expecting twins could be counted as one person under Marketplace rules and as three people under Medicaid rules.

7. Students

Under IRS rules, an individual must be under age 19 to be a "qualifying child" unless he or she is a full time student.[177] A student is an individual who, in at least five months of a calendar year, was enrolled full-time at a qualified educational organization or training institution. IRS regulations allow students younger than 24 to be considered "qualifying

[175] 77 Fed. Reg. at 17158.
[176] 26 I.R.C. § 152(f)(1)(C).
[177] 26 I.R.C. § 152(c)(3)(A)(i).

children."[178] Students may also be claimed as tax dependents if they meet the requirements for "qualifying relatives."

Under Medicaid/CHIP MAGI, generally, children must be under age 19, though MAGI regulations allow states to extend that age limit to 21 for full time students.[179] Thus, a 22-year-old full-time student could be counted as a child under Marketplace rules, but would be an adult under Medicaid MAGI.

8. Individuals who are lawfully present

Individuals who are lawfully present in the U.S. can qualify for APTCs and cost sharing assistance in the Marketplace.[180] To qualify for APTCs, an applicant must be lawfully present for the entire enrollment period, generally a year, in which the tax credit is being claimed.[181] The ACA also includes a special rule for APTC eligibility for lawfully present individuals who would otherwise be eligible for Medicaid but for their immigration status.[182] These low-income individuals can qualify for APTCs and cost sharing assistance in the Marketplace, even if their household income would otherwise meet the state's Medicaid eligibility thresholds and is below the statutory threshold of 100% FPL. The amount of their APTC would be calculated based on their actual income.[183] This rule applies to all lawfully present individuals who are ineligible for Medicaid solely due to their immigration status, even in states that chose not to expand Medicaid.

Lawfully present individuals can be tax filers or tax dependents. As a result, these persons will be counted as members of the Marketplace tax household, and income they earn will be counted when calculating APTCs/CSRs.

9. Individuals who are not lawfully present

Under existing IRS rules, individuals who are not lawfully present and who do not have a valid Social Security Number can file federal taxes using an Individual Taxpayer Identification Number (ITIN).[184] This is because the IRS requires anyone who resides and earns income in the U.S. to file taxes regardless of immigration status.[185]

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[178] 26 I.R.C. § 152(c)(3)(A)(ii).
[179] 42 C.F.R. § 435.603(f)(3)(iv).
[180] *See* 42 U.S.C. § 18032(f);); 45 C.F.R. § 155.305(a)(1) (defining "qualified individual"). *See also* 26 I.R.C. § 36B(e)(2); 42 U.S.C. § 18071(e)(2) (defining "lawfully present" generally); 26 C.F.R. § 1.36B-1(g) (APTCs); 45 C.F.R. § 155.20 (CSRs).
[181] 26 I.R.C. § 36B(e)(2).
[182] 26 I.R.C. § 36B(c)(1)(B); 26 C.F.R. § 1.36B-2(b)(5).
[183] 26 C.F.R. § 1.36B-2(b)(7).
[184] *See generally* IRS, *General ITIN Information* (July 10, 2013) *available at* http://www.irs.gov/Individuals/General-ITIN-Information; IRS, *Taxpayer Identification Numbers* (May 13, 2013) *available at* http://www.irs.gov/Individuals/International-Taxpayers/Taxpayer-Identification-Numbers-(TIN).
[185] *See generally* IRS, *Classification of Taxpayers for U.S. Tax Purposes* (June 25, 2013) *available at* http://www.irs.gov/Individuals/International-Taxpayers/Classification-of-Taxpayers-for-U.S.-Tax-Purposes;

Yet, even if they file federal taxes, individuals who are not lawfully present are not eligible for APTCs/CSRs.[186] However, in a mixed status family, there may be family members who are lawfully present or U.S. citizens and those who are not lawfully present. Individuals in a mixed status family who are lawfully present or U.S. citizens remain eligible for APTCs/CSRs. As a result, the ACA allows a tax filer who is not lawfully present to apply for APTCS/CSRs on behalf of eligible tax dependents who are U.S. citizens or lawfully present.[187] A typical example would be a head of household who is not lawfully present and files taxes under an ITIN and who claims tax dependents (spouse, children) who are U.S. citizens or are lawfully present (and who have SSNs). The spouse and dependents who are citizens or lawfully present may be eligible for APTCs/CSRs even though the tax filer is ineligible.

According to guidance issued by the U.S. Immigration and Customs Enforcement (ICE), authorities will not use information provided for IAP eligibility determinations in immigration enforcement actions.[188]

10. Special income counting rule for APTCs for mixed status families

There is a special income counting rule for calculating the APTCs of eligible individuals in a mixed status family to account for ineligible family members.[189] First, when determining who in the household shall be counted as members of the tax household, those who are not lawfully present are *excluded* as members of the tax household.[190] Second, when determining whose income in the household is counted, the income earned by family members who are not lawfully present must be *included* in the sum total of the household income.[191] A complex mathematical formula is then used to calculate the household income for APTCs in relation to the Federal Poverty Level.[192] The ACA also allows the use of a "comparable method" to calculate household income for APTCs in this situation.[193] To date, the IRS has not promulgated further guidance to implement this special income counting rule for mixed status families or to explain what types of comparable methods may be used by state exchanges.

IRS, *Taxation of Resident Aliens* (Apr. 17, 2013) *available at* http://www.irs.gov/Individuals/International-Taxpayers/Taxation-of-Resident-Aliens.

[186] 42 U.S.C. § 18082(d) ("Nothing in this subtitle or the amendments made by this subtitle allows Federal payments, credits, or cost-sharing reductions for individuals who are not lawfully present in the United States.").

[187] 26 C.F.R. § 1.36B-2(b)(4) (stating that an individual who is not lawfully present "may be an applicable taxpayer if a family member is eligible to enroll in a qualified health plan.").

[188] U.S. Immigration and Customs Enforcement, *Clarification of Existing Practices Related to Certain Health Care Information,* Oct. 25, 2013, available at http://www.ice.gov/doclib/ero-outreach/pdf/ice-aca-memo.pdf.

[189] 26 I.R.C. § 36B(e)(1)(B)(i)(II); 26 CFR 1.36B-3(l)(2).

[190] 26 I.R.C. § 36B(e)(1)(B)(i)(I); 26 CFR 1.36B-3(l)(1).

[191] 26 I.R.C. § 36B(e)(1)(B)(i)(II); 26 CFR 1.36B-3(l)(2).

[192] 26 I.R.C. § 36B(e)(1)(B)(i)(II)(aa)-(bb).

[193] 26 I.R.C. § 36B(e)(1)(B)(ii); 26 CFR §1.36B-3(l)(2)(ii).

EXAMPLE: Family with mixed immigration status

Mike and Nancy have two children, Oscar and Priscilla and live in the state of Westonia. Mike, a Canadian, is not lawfully present, but still works and earns income in the U.S. Nancy, Oscar and Priscilla are U.S. citizens. Mike files federal income taxes jointly with Nancy, using his ITIN, and claims the children as tax dependents. The family's household income is above Westonia's Medicaid eligibility threshold.

Mike applies for IAPs for his family, but he is not eligible for APTCs/CSRs because he is not lawfully present. He is not counted as a member of the tax household, even though he is the tax filer.

The tax household for Nancy, Oscar, and Priscilla is comprised of the three of them. The household income for the tax household of 3 will include Mike's income, adjusted according to a formula prescribed by the ACA or comparable method.

C. Family Size in Medicaid/CHIP

1. General principles

Under MAGI rules, the tax household and the Medicaid/CHIP household will in many cases be the same. However, there are a number of differences in the calculation of family size and income for Medicaid and CHIP eligibility that differ from the Marketplace MAGI rules.

Medicaid rules include several important exceptions designed to help facilitate eligibility and enrollment for certain vulnerable populations, such as children in single parent households and very low income individuals being cared for by others. Medicaid rules also give states flexibility to decide how certain individuals, such as pregnant women and students, will be counted. Finally, new Medicaid/CHIP MAGI rules require states to count the income of certain individuals, such as stepparents, whose income traditionally has not counted toward a child's Medicaid eligibility.[194]

[194] A series of court decisions enjoined state policies that allowing deeming from individuals other than spouses and parents to children. *See* NHeLP, *The Advocate's Guide to the Medicaid Program*, 3.63-3.64, n. 273-75 (collecting cases). The MAGI rules could affect continued application of these injunctions. For example, since the early 1990's, states in the Ninth Circuit have been subject to an injunction issued in *Sneede v. Kizer, 951 F.2d 362 (9th Cir. 1990),* which prohibited Medicaid from deeming income or resources from a stepparent, stepchild, a natural child and/or a sibling or half-sibling. The injunction in *Sneede* was based on a provision in 42 U.S.C. § 1396a(a)(17) that prohibited such deeming of income. Under the ACA, 42 U.S.C. § 1396a(e)(14), Section (a)(17) will not apply to income determinations using MAGI. Thus, there is no longer a legal prohibition for counting the income of stepparents, etc. The *Sneede* Court granted a modification of *Sneede* due to this change in the law, but the *Sneede* injunction remains in effect in regard to all non-MAGI eligibility determinations.

In Medicaid and CHIP, different members of the same household may have a different family size, while in the Marketplace the family size is the same for each member of the household. Determining a Medicaid household requires a person-by-person analysis that asks:

- Who is seeking an eligibility determination?
- With whom does the individual live?
- What are the relationships among individuals in the household?

An analysis to determine who is in the Medicaid household begins with the tax filer and his or her claimed dependents. Some of the questions used to determine an individual's family size in Medicaid/CHIP include:

1. Does the individual expect to file taxes?
2. Does the individual expect to be claimed as a dependent by someone else?
3. Is the individual a U.S. citizen or lawfully present?
4. Who lives in the household at least half the year, or year round?
5. Is anyone a full time student?
6. Is anyone pregnant? How many babies are expected?
7. Is anyone married? Are they in a same sex or opposite sex marriage?
8. Is anyone under age 19?
9. How are individuals related to each to other?
10. What are the state's Medicaid rules for same sex marriage and for counting pregnant women?

RESOURCE: See Appendix E for a quick reference chart summarizing the rules for counting the **Marketplace and Medicaid/CHIP Household**, as described below.

2. Rules for counting the Medicaid/CHIP household

As explained above, the household composition and size for APTCs/CSRs is the tax household, which includes the tax filer(s) and dependents. Only tax filers and household dependents can be eligible for APTCs/CSRs.

The same basic rules apply to determine Medicaid household size, with some key differences. In addition, because some low income individuals and families are not required to file federal income taxes, several special Medicaid rules for non-filers also apply.

Generally, the Medicaid household rules divide individuals who are seeking an eligibility determination into the following three categories:

- Those who file taxes and are not claimed as dependents by someone else;

- Those claimed by someone else as a dependent; and

- Non-filers who do not file taxes and are not claimed as a dependent by someone else.[195]

Medicaid household counting rules also contain special provisions to account for pregnant women, unmarried couples with children, multi-generational and extended families, parents who are separated or divorced, and individuals whom the taxpayer expects to claim as a dependent but cannot reasonably establish so according to the state's eligibility verification systems.

RESOURCE: See Appendix F for NHeLP's one page quick reference guide - **MAGI Household Composition** – as well as several flow charts prepared by state advocates.

a) Tax filers who are not claimed as dependents

The first step in determining Medicaid household size is to ask if the individual seeking an eligibility determination expects to file a federal tax return.

Income, age, and filing status all factor into whether an individual must file a tax return. Every January, IRS publishes filing requirements for individuals and families for the preceding year.[196] For example, individuals under 65 whose gross income was less than $10,000 in 2013 are not required to file an income tax return for the 2013 tax year.[197]

The second step is to determine if the tax filer is expected to be claimed as a dependent by another taxpayer.

An individual can file taxes, yet still be claimed as a dependent on the tax return of another if that individual meets the specifications for a qualifying child or qualifying relative. For example, an 18 year old daughter with a part time job could be claimed as a dependent by her parents if her income does not provide her with more than one half of her annual support. The daughter may want to file her own tax return to obtain a refund if taxes were taken out of her paycheck. She would still count as a member of her family's tax household, and her income may or may not count toward the total household income under both Marketplace and Medicaid MAGI rules.

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[195] 42 C.F.R. § 435.603(f).
[196] *See e.g.* IRS, Publication 17, *Tax Guide 2012 for Individuals* (Jan. 31, 2013), *available at* http://www.irs.gov/pub/irs-pdf/p17.pdf.
[197] *Id.*

If the individual is a tax filer who does not expect to be claimed as a dependent by another, then the Medicaid household for the tax filer will be the tax filer and his or her dependents. In this scenario, the Marketplace household is the same as the Medicaid household for the tax filer. Note that the Medicaid household for the tax filer will not necessarily be the same as the Medicaid household for his or her dependents.

b) Individuals expected to be claimed as a dependent by a tax filer

Generally, Medicaid rules count individuals claimed as dependents by a tax filer as members of that tax filer's tax household. In this respect, the Medicaid household and the Marketplace household are often the same. There are, however, three significant exceptions:

i. Individuals other than a spouse or a child who expect to be claimed as a tax dependent by a tax filer

Individuals who expect to be claimed as a tax dependent by a tax filer, but who are not a spouse or child of that tax filer, are subject to an exception to the Marketplace MAGI household rules.[198] Under IRS rules, a "qualifying relative" can be claimed by a tax filer as a dependent if certain requirements are met (e.g., low income, depends on tax filer for at least one half of financial support, is a relative, or can be a non-relative who lives with the taxpayer year round).

A separate set of Medicaid/CHIP rules allow some such individuals to be treated as their own household for purposes of Medicaid/CHIP eligibility.[199] This situation would most commonly arise where there are multiple generations or extended family members who are very low income and living in the same household. Under the rules for non-filers and non-dependents, the Medicaid/CHIP MAGI household consists of:

- The individual;
- The individual's spouse, if living with the individual;
- The individual's children, if living with the individual and under age 19 (or 21 if a full-time student).[200]

CMS provides the following example of how the Medicaid/CHIP MAGI household can diverge from the Marketplace MAGI household size:

> [C]onsider Taxpayer Joe, an adult (not himself expected to be claimed as a tax dependent) who claims Uncle Harry as a tax dependent. Harry is not expected to be required to file a tax return. Consistent with the 36B definitions, Harry is included in Joe's family size for purposes of Joe's

[198] 42 C.F.R. § 435.603(f)(2)(i).
[199] 42 C.F.R. § 435.603(f)(2)(i).
[200] 42 C.F.R. § 435.603(f)(3)(iv).

eligibility per § 435.603(f)(1), but Harry's income is not counted in Joe's household income under § 435.603(d)(2)(ii). Under § 435.603(f)(2)(i) and (f)(3) of our regulations, Harry will be considered for Medicaid eligibility as a separate household, and under § 435.603(d)(1), Harry's income will be counted in determining his own eligibility.[201]

Harry's Marketplace household

Under Marketplace rules, Joe and Harry are considered members of the same tax household because Joe claims Harry as a dependent. However, because Harry's income is so low (below the threshold requiring filing of a tax return), it does not count toward the total household MAGI income.

Harry's Medicaid/CHIP household

Under Medicaid/CHIP rules, Harry is in his own, separate household, because, although Joe claims Harry as a dependent, Harry is neither Joe's spouse nor his child. Therefore, Harry falls under the special Medicaid rule that requires him to count as his own household. Harry's income will be considered for purposes of his own Medicaid eligibility, but Joe's income will not. Moreover, if Harry were living with his spouse, Harry and his spouse would be counted as members of their own household. Joe's Medicaid household consists of himself and Harry.

ii. A child claimed by one parent as a dependent and who is living with both parents who do not file a joint tax return

The second special Medicaid household rule applies to a child claimed by one parent as a dependent and who is living with both parents who do not file a joint tax return.[202] (A child is someone under age 19 or age 21 for full time students at state option.)[203]

Under the Marketplace rules, married couples must file a joint tax return to receive APTCs. Unmarried couples, even those with children, may not file a joint tax return, and therefore cannot qualify for APTCs as a family unit (although they could qualify individually or as separate tax households).

In Medicaid, eligibility has long been based upon the income of those legally responsible for a minor, including parents who are not married. Therefore, Medicaid has carved out a special rule that counts the household and income of unmarried parents when determining the eligibility of a minor child. The Medicaid household for a minor

[201] 77 Fed. Reg. at 17152.
[202] 42 C.F.R. § 435.603(f)(2)(ii).
[203] 42 C.F.R. § 435.603(f)(3)(iv).

child is determined according to the special rules for non-filers and non-dependents, and not the general rule for dependents, if the following conditions are met:

- The child must be claimed as a dependent by a parent;
- The child must be living with both parents; and
- The parents are not expected to file a joint income tax return.[204]

If all three conditions are met, the Medicaid household is comprised of the child and each of the following who are living with the child:

- The child's parents;
- The child's spouse;
- The child's children (under age 19 or 21 for full time students); and
- The child's siblings (under age 19 or 21 for full time students) and parents.[205]

iii. A child claimed as a dependent by a parent that the child does not live with

Noncustodial parents may claim a child as a dependent if the legal requirements for a qualifying child are met. However, Medicaid has special rules to allow a child to be counted as a member of the household of the custodial parent or the parent with whom the child spends the most nights.[206]

The Medicaid household for child who is claimed as a tax dependent by a non-custodial parent is determined according to the same rules that apply to non-filers who are not claimed as a dependent by anyone.

Under the rules for non-filers and non-dependents, the household consists of:

- The child;
- The child's parent and siblings who live with the child;
- The child's spouse, if living with the child;
- The child's children, if living with the child and under age 19.[207]

[204] 42 C.F.R. § 435.603(f)(2)(i).
[205] 42 C.F.R. §§ 435.603(f)(3)(i)-(iv).
[206] 42 C.F.R. § 435.603(f)(2)(iii)(B).
[207] 42 C.F.R. § 435.603(f)(3).

EXAMPLE: Child claimed as a dependent by a non-custodial parent

Mike and Carol are divorced and have one child, Marcia. Marcia lives with Carol, who has primary custody, but spends every other weekend with Mike. Mike and Carol agreed that Mike can claim Marcia as a dependent because she meets the requirements of a qualifying child. Marcia's Marketplace household is comprised of Mike and Marcia. However, Marcia's Medicaid household is determined under the rules for non-tax filers because she is claimed as a dependent by a non-custodial parent. Marcia's Medicaid household is Marcia and Carol.[208] And, note that, if Mike is paying child support, it will NOT be counted as income in Marcia's Medicaid household under MAGI rules.

If Carol files taxes and is not claimed as a dependent by someone, then her Medicaid and tax household would be the same – just her. If Carol does not expect to file taxes nor be claimed as a dependent, then her Medicaid household would be determined under the rules for non-filers who are not claimed as a dependent by someone else. In that case, Carol's Medicaid household would be two – Carol and Marcia.[209] If Carol does not file federal income taxes and is not claimed as a tax dependent by anyone, she would not be eligible for APTCs.

c) Non-filers who do not file taxes and who are not claimed as a dependent by someone else

For individuals who do not expect to file a Federal tax return and do not expect to be claimed as a tax dependent for the taxable year in which an initial determination or renewal of eligibility is being made, the Medicaid/CHIP household consists of:

- The individual;
- The individual's spouse if living with the individual; and
- The individual's children if living with the individual and if the children meet the age requirements specified by the state.[210]

If the individual is a minor as specified by the state, the Medicaid household includes:

- The individual;
- The individual's parents (if living with the individual); and
- The individual's siblings (if living with the individual and if the siblings meet the age requirements specified by the state).[211]

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[208] *See* 42 C.F.R. § 435.603(f)(2)(iii).
[209] *See* 42 C.F.R. § 435.603(f)(2)(ii).
[210] 42 C.F.R. §§ 435.603(f)(3)(i), (iv).
[211] 42 C.F.R. § 435.603(f)(3)(iii).

Children must be under age 19 to be counted as Medicaid household members under the preceding provisions. However, states have the option to count full time students under age 21 as children.[212]

NOTE: Medicaid MAGI rules do not specify what it means to be "living with" someone for determining the household of non-filers and non-dependents. A typical example would be a child who splits time evenly with parents who live separately when neither of them files a tax return. The child's Medicaid household should be determined under 435.603(f)(3)(iii), since the child would be an individual who is neither filing a tax return nor claimed as a dependent on another's tax return. Under this rule, the child is in the household with the parent(s) with whom the child is living. But the rule does not seem to indicate how to determine the parent with whom the child is living if time is split. Under (f)(2), this is determined according to the parent with whom the child spends the most nights. Presumably that rule would apply under (f)(3) also.

d) Married couples living together

A married couple living together will be counted as members of the same Medicaid household regardless of whether they expect to file a joint tax return.[213] (As explained above, for Marketplace purposes, they *must* file a joint tax return in order to be eligible for APTCs/CSRs).

e) Pregnant women and Medicaid

States have flexibility to decide how they count pregnant women for the purposes of Medicaid eligibility. If a pregnant woman is seeking an eligibility determination, a state counts her as one, plus the number of children she expects to have, when determining her household size.[214]

However, when determining eligibility for other individuals who have a pregnant woman in their household, the state can elect to count the pregnant woman as either one person, two persons, or one person plus the number of children she is expected to deliver. Thus, for the purposes of her own eligibility, a pregnant woman expecting twins would be counted as three people. If other individuals in her household apply for coverage, she would, at state option, be counted as one, two, or three people.

[212] 42 C.F.R. § 435.603(f)(3)(iv).
[213] 42 C.F.R. § 435.603(f)(4).
[214] 42 C.F.R. § 435.603(b).

EXAMPLE: Marketplace v. Medicaid rules for counting pregnant women

Jesse and Tara are married and file a joint tax return. Tara is pregnant and expecting twins. Their combined MAGI income is $30,000 per year. The state's Medicaid program covers pregnant women up to 150% FPL, and counts pregnant women as one person plus the number of babies expected when determining eligibility of someone else in her household.

The Marketplace household size for both Tara and Jesse would be two, which places them at 193% FPL.

However, using the Medicaid household counting rules, Tara's family size is four (herself, Jesse, and two unborn children). Tara qualifies for Medicaid because her household income is 127% FPL, well under the state's maximum for pregnant women. Jesse's Medicaid household would also be four under the state's rules, qualifying him for the new Medicaid adult group, if available.

EXAMPLE: Medicaid rules for pregnant women and household size

Jesse and Tara are unmarried and live with Tara's mother. Tara is 18, pregnant and expecting twins. Tara's mother claims both Tara and Jesse as dependents because they meet the requirements as a qualifying child and a qualifying relative. Their Marketplace household is three. The state where they live has opted to count a pregnant woman as two people, regardless of how many babies she is expecting, when the state determines eligibility for individuals with a pregnant woman in the household. For Tara's mother, the Medicaid household size would be four, including her, Jesse, and Tara counted as two people (mother plus one baby).[215] Jesse's Medicaid household size is one, because, although he is claimed by Tara's mother as a dependent, he is determined under the rules for non-filers because he is neither Tara's mother's spouse nor child.[216] Tara's Medicaid household size is five, including her mother, Jesse, and herself, counted as three people because the eligibility determination is being made for her.[217]

[215] *See* 42 C.F.R. § 435.603(f)(1) (For tax filers who are not claimed as tax dependent, the filer's household consists of the filer and all persons whom the filer expects to claim as tax dependent).
[216] *See* 42 C.F.R. §§ 435.603(f)(2)(i), 435.603(f)(3).
[217] *See* 42 C.F.R. §§ 435.603(f)(1), 435.603(f)(a).

f) Same sex marriages

In June 2013, the Supreme Court overturned Section 3 of the "Defense of Marriage Act" which previously prohibited the federal government from recognizing same sex marriages.[218] Accordingly, the IRS issued guidance requiring recognition of same sex marriages for purposes of APTC/CSR eligibility, even if the couple lives in a state that does not recognize their marriage (see discussion in Section IV.B.1 of this Guide). However, CMS issued guidance allowing states to decide whether to recognize same sex marriages for purposes of determining eligibility for Medicaid and CHIP.[219] This state flexibility applies to all MAGI categories and populations, where marital status plays a key factor in determining household size.

However, for non-MAGI eligibility determinations, same sex marriages will be recognized if marital status is determined according to federal rules. For example, Medicaid eligibility on the basis of SSI does not require the state to consider the marital status or household size of an applicant.[220] CMS stated it will provide further guidance once the Social Security Administration issues its own guidance in the wake of *Windsor*.[221]

EXAMPLE: Medicaid/CHIP household for same sex marriage

Christine and MaryBeth married in the District of Columbia, where same sex marriage is legal. They moved to suburbs in Virginia to raise their two children, Ike and Spike. Virginia does not recognize their marriage. Christine and MaryBeth file joint federal income tax returns and claim both children as tax dependents.

When they apply for IAPs, their Marketplace household is the tax household including all four of them. However, their Medicaid household composition is the following:

- Christine's Medicaid household is 3, including herself (as a tax filer) and the two children she claims as dependents
- MaryBeth's Medicaid household is also 3, including herself (as a tax filer) and the two children she claims as dependents
- Ike and Spike's Medicaid household is 4, including both of them and both parents.

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[218] *U.S. v. Windsor*, 570 U.S. __, 133 S. Ct. 2675 (2013).
[219] CMS, *Dear State Health Official & State Medicaid Director Letter* (Sept. 27, 2013) (United States v. Windsor).
[220] CMS, *Dear State Health Official & State Medicaid Director Letter* (Sept. 27, 2013), at 4 (United States v. Windsor) (Note that it is unclear whether a 209(b) state could apply its own marriage definition).
[221] *Id.*

V. Household Scenarios

The following are typical household scenarios. They demonstrate how the different rules for Medicaid and Marketplaces can result in different household sizes for the same person.

> **REOURCE:** NHeLP developed a **Household Composition Worksheet,** available in Appendix G, to help sort complex family situations.

Household #1 – Married couple

Ann and Bob are married and live together. They file a joint federal income tax return and have no dependents.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann	Married to Bob	Files joint tax return with Bob	Ann, Bob § 36B(d)(1)	Ann, Bob § 435.603(f)(1)
Bob	Married to Ann	Files joint tax return with Ann	Ann, Bob § 36B(d)(1)	Ann, Bob § 435.603(f)(1)

Household #2 – Unmarried couple

Ann and Bob are unmarried and live together. They file separate federal income tax returns, and have no dependents.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob	Unmarried	Files separate tax return	Ann § 36B(d)(1)	Ann § 435.603(f)(1)
Bob, lives with Ann	Unmarried	Files separate tax return	Bob § 36B(d)(1)	Bob § 435.603(f)(1)

Household #3 – Married couple expecting twins

Ann and Bob are married and live together. They file a joint federal income tax return and have no dependents. Ann is pregnant and expecting twins. The state where they live counts pregnant women as two, regardless of how many babies she is expecting, when determining eligibility of someone with a pregnant woman in the household.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob	Married to Bob, pregnant (2 babies expected)	Files joint tax return with Bob	Ann, Bob § 36B(d)(1)	Ann, 2 unborn children, Bob § 435.603(f)(1) § 435.603(b)
Bob, lives with Ann	Married to Ann	Files joint tax return with Ann	Ann, Bob § 36B(d)(1)	Ann, 1 unborn child, Bob § 435.603(b) § 435.603(f)(1)

Household #4 – Divorced couple with children

Ann and Bob are divorced and live apart. Ann has custody of the twins Corey and Didi. Ann claims Corey as a dependent, while Bob claims Didi.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Corey and Didi	Divorced	Files separate tax return, claims Corey as a dependent	Ann, Corey § 36B(d)(1)	Ann, Corey § 435.603(f)(1) § 435.603(f)(2)
Bob, lives alone	Divorced	Files separate tax return, claims Didi as a dependent	Bob, Didi § 36B(d)(1)	Bob § 435.603(f)(1) § 435.603(f)(2)(iii)
Corey, lives with Ann	Child of Ann, Bob	Claimed by Ann	Ann, Corey § 36B(d)(1)	Ann, Corey § 435.603(f)(2)
Didi, lives with Ann	Child of Ann, Bob	Claimed by Bob	Bob, Didi § 36B(d)(1)	Ann, Corey, Didi § 435.603(f)(2)(iii) § 435.603(f)(3)(iii)

Household #5 – Married with children who file taxes

Ann and Bob are married and living together. They file a joint federal income tax return. They have two children, Corey and Didi, whom they claim as dependents. Didi has a summer job, earning $3000 for college. Didi will file her own separate federal income tax return to obtain a refund of the taxes withheld from her paychecks. She may not claim a personal exemption because Ann and Bob claim her as a dependent.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob, Cory, Didi	Married to Bob; mother to Corey and Didi	Files joint tax return with Bob; claims Corey, Didi	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)
Bob, lives with Ann, Corey, Didi	Married to Ann; father to Corey and Didi	Files joint tax return with Ann; claims Corey, Didi	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)
Corey, lives with Ann, Bob, Didi	Child of Ann and Bob; sibling to Didi	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi, § 435.603(f)(2)
Didi, lives with Ann, Bob, Corey	Child of Ann and Bob, sibling to Corey	Files her own tax return but is claimed as a dependent by Ann and Bob	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)(2)

Household #6 – Married with children who file taxes and claim a personal exemption

Ann and Bob are married and living together. They file a joint federal income tax return. They have two children, Corey and Didi. Ann and Bob claim Corey as a dependent. Didi lives at home and has a summer job, earning $10,000 for college. Didi files her own separate federal income tax return and claims a personal exemption on her taxes.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob, Corey, Didi	Married to Bob; mother to Corey and Didi	Files joint tax return with Bob; claims Corey	Ann, Bob, Corey § 36B(d)(1)	Ann, Bob, Corey § 435.603(f)
Bob, lives with Ann, Corey, Didi	Married to Ann; father to Corey and Didi	Files joint tax return with Ann; claims Corey	Ann, Bob, Corey § 36B(d)(1)	Ann, Bob, Corey § 435.603(f)
Corey, lives with Ann, Bob, Didi	Child of Ann and Bob; sibling to Didi	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey § 36B(d)(1)	Ann, Bob, Corey § 435.603(f)(2)
Didi, lives with Ann, Bob, Corey	Child of Ann and Bob, sibling to Corey	Files her own tax return and claims her own personal exemption	Didi § 36B(d)(1)	Didi § 435.603(f)(1)

Household #7 – Family with dependent relative

Ann and Bob are married and live together. They file a joint federal income tax return. They have two children, Corey and Didi, whom they claim as dependents. They live with Ann's Aunt Ellen, who takes care of the twins and has no income source. Ellen does not file federal income taxes. Ann and Bob claim Ellen as a dependent because she meets the requirements for a "qualifying relative."

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob, Corey, Didi, Ellen	Married to Bob; mother to Corey and Didi	Files joint tax return with Bob; claims Corey, Didi	Ann, Bob, Corey, Didi, Ellen § 36B(d)(1)	Ann, Bob, Corey, Didi, Ellen § 435.603(f)
Bob, lives with Ann, Corey, Didi, Ellen	Married to Ann; father to Corey and Didi	Files joint tax return with Ann; claims Corey, Didi	Ann, Bob, Corey, Didi, Ellen § 36B(d)(1)	Ann, Bob, Corey, Didi, Ellen § 435.603(f)

Household #7 (Continued)

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Corey, lives with Ann, Bob, Didi, Ellen	Child of Ann and Bob; sibling to Didi	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey, Didi, Ellen § 36B(d)(1)	Ann, Bob, Corey, Didi, Ellen § 435.603(f)(2)
Didi, lives with Ann, Bob, Corey, Ellen	Child of Ann and Bob, sibling to Corey	Files her own tax return but is claimed as a dependent by Ann and Bob	Ann, Bob, Corey Didi, Ellen § 36B(d)(1)	Ann, Bob, Corey, Didi, Ellen § 435.603(f)(2)
Ellen, lives with Ann, Bob, Corey, Didi	Aunt to Ann	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey, Didi, Ellen § 36B(d)(1)	Ellen § 435.603(f)(2)(i) § 435.603(f)(3)

Household #8 – Estranged couple with children filing jointly

Ann and Bob are in the process of getting a divorce and live apart. They have two children, Corey and Didi, living with Ann, and whom they claim as dependents. Although living apart, they intend to continue to file a joint tax return for the coming tax year.

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Cory, Didi	Married to Bob; mother to Corey and Didi	Files joint tax return with Bob; claims Corey, Didi	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)
Bob	Married to Ann; father to Corey and Didi	Files joint tax return with Ann; claims Corey, Didi	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)
Corey, lives with Ann, Didi	Child of Ann and Bob; sibling to Didi	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey Didi § 36B(d)(1)	Ann, Bob, Corey, Didi, § 435.603(f)(2)
Didi, lives with Ann, Corey	Child of Ann and Bob, sibling to Corey	Claimed as a dependent by Ann and Bob	Ann, Bob, Corey, Didi § 36B(d)(1)	Ann, Bob, Corey, Didi § 435.603(f)(2)

Household #9 – Estranged couple with children filing separately

Ann and Bob are in the process of getting a divorce but still live together. They have two children, Corey and Didi. Ann and Bob still live together, but intend to file separate tax returns. Bob claims both children as dependents

Who's who? Lives here? All year?	Relationship? Marital Status? Pregnant?	Tax filer? Dependent? Exception?	Who is in this person's Marketplace household?	Who is in this person's Medicaid/CHIP household?
Ann, lives with Bob, Corey, Didi	Married to Bob; mother to Corey and Didi	Files own tax return	Ann (not eligible for APTCs because she is married, filing separately) § 36B(d)(1) § 36B(c)(1)(C)	Ann, Bob § 435.603(f)(4)
Bob, lives with Ann, Corey, Didi	Married to Ann; father to Corey and Didi	Files own tax return; claims Corey, Didi	Bob, Corey, Didi (not eligible for APTCs because he is married, filing separately) § 36B(d)(1) § 36B(c)(1)(C)	Ann, Bob, Corey, Didi § 435.603(f)(1) § 435.603(f)(4)
Corey, lives with Ann, Bob, Didi	Child of Ann and Bob; sibling to Didi	Claimed as a dependent by Bob	Bob, Corey, Didi, (not eligible for APTCs because married parents file separately) § 36B(d)(1) § 36B(c)(1)(C)	Ann, Bob, Corey, Didi, § 435.603(f)(4)
Didi, lives with Ann, Bob, Corey	Child of Ann and Bob, sibling to Corey	Claimed as a dependent by Bob	Bob, Corey, Didi (not eligible for APTCs because married parents file separately) § 36B(d)(1) § 36B(c)(1)(C)	Ann, Bob, Corey, Didi § 435.603(f)(4)

VI. MAGI Conversion for Medicaid and CHIP

One consequence of switching to the new MAGI-based income counting methodology is that some individuals stand to lose Medicaid or CHIP eligibility due to the transition. The ACA requires that states use an income equivalency test to ensure the transition to MAGI does not result in a net loss of eligibility.[222] CMS has interpreted this to mean that the conversion of current income limits to MAGI-equivalent thresholds should not result in an "aggregate" loss of eligibility. Because conversion applies in aggregate, rather than on an individual basis, not everyone will be protected by the conversion of the thresholds.[223] Some individuals will lose eligibility, but, if the methodology is sound, on average an equal number of individuals should stand to gain eligibility. In other words, the conversion should "not systematically increase or decrease the number of eligible individuals within a given eligibility group."[224]

MAGI conversion must be implemented on a state-by-state basis, since states have varying eligibility categories and varying rules about deductions and disregards. However, CMS has developed a uniform conversion methodology for State Medicaid agencies to measure the "effective" income standard for each eligibility category. States were required to either use that approach to convert current income standards into equivalent MAGI-based standards or seek CMS approval to use a variation of that methodology.[225]

A. Eligibility Categories Subject to MAGI-conversion

States will not convert every Medicaid eligibility category or threshold, but categories in some way connected to the transition to MAGI will require conversion. These state thresholds include:

- All current mandatory, optional and § 1115 demonstration categories subject MAGI in 2014;

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[222] 42 U.S.C. § 1396a(e)(14)(A) ("A State shall establish income eligibility thresholds for populations to be eligible for medical assistance under the State plan or a waiver of the plan using modified adjusted gross income and household income that are not less than the effective income eligibility levels that applied under the State plan or waiver on the date of enactment of the Patient Protection and Affordable Care Act.").

[223] *See* CMS, *Conversion of Net Income Standards to Equivalent Modified Adjusted Gross Income Standards and Solicitation of Public Input* (June 21, 2012), at 4-5 ("The intent is for States to establish MAGI-equivalent standards that protect individuals eligible for medical assistance under the State Plan or under a waiver prior to 2014. The reference in the statute to 'populations' means that the analysis regarding 'not losing coverage' should be in the aggregate. It would be virtually impossible to ensure that not one individual loses coverage due to the elimination of income disregards without substantially raising income standards beyond the current standards, which would significantly expand coverage beyond the intent of the Affordable Care Act") (internal citations omitted).

[224] CMS, *Dear State Health Official & State Medicaid Director Letter* (Dec. 28, 2012), at 2 (Conversion of Net Income Standards to MAGI Equivalent Income Standards).

[225] *Id.* at 4-5

- Maximum eligibility thresholds for newly consolidated eligibility groups for parents and other caretaker relatives (§ 435.110), pregnant women (§ 435.116), children under age 19 (§ 435.118), and the new adult group (§ 435.119);
- Minimum statutory thresholds for pregnant women and parents and caretaker relatives;
- December 1, 2009 thresholds for mandatory, optional and § 1115 demonstration categories connected to the new adult group (§ 435.119) to determine who is newly eligible and qualifies for enhanced FMAP;
- Income thresholds for charging premiums under 42 U.S.C. § 1396o-1.[226]

Current income thresholds for non-MAGI categories are not affected by the MAGI conversion requirement.

B. The Mechanics of MAGI Conversion

After considering more than one possible conversion method and seeking public comment, CMS adopted a standardized MAGI conversion approach for every state Medicaid program: the Marginal Disregard Method.[227] Using this method, CMS calculated MAGI-converted eligibility thresholds for all states using national survey data, from the Survey of Income and Program Participation Data (SIPP), weighted for each state. States choosing this method could either rely on the SIPP data as calculated by CMS or use their own state-specific data, with CMS approval. States were also given the flexibility to propose alternative methodologies, but again only with Secretary approval.

NOTE: Due to limitations in the SIPP database, the methodology may not take into account every single potential disregard, but does include earned and unearned income, work expenses, child support paid and received, interest and dividend income, SSDI income, student income and dependent care expenses.[228]

The Marginal Disregard Method adjusts the applicable Medicaid income eligibility standard for each current eligibility group (e.g., § 1931 parents and caretaker relatives) by calculating the average size of disregards (under current income counting rules) for a representative sample population. The sample for any given category consists of all individuals in the SIPP database who meet the non-income eligibility criteria and whose household income is in a "marginal band" within 25% FPL below a state's net income

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[226] CMS, *Dear State Health Official & State Medicaid Director Letter* (Dec. 28, 2012), at 3 (Conversion of Net Income Standards to MAGI Equivalent Income Standards). See 42 U.S.C. § 1396o-1 for the provisions on alternative premiums and cost-sharing.
[227] *Id.* at 4.
[228] ASPE, *Data Sources for Modified Adjusted Gross Income (MAGI) Conversions* 7, 10 (Feb. 2013) http://aspe.hhs.gov/health/reports/2013/sipp/ib.cfm.

standard for that eligibility category.[229] For example, a category with a 100% FPL eligibility standard under current rules would have a marginal band from 75% to 100% FPL. CMS calculates the value of disregards for each individual in the SIPP sample for that category, converted to percent FPL. Next, it totals these individuals' disregards and finds the average. Assuming the average disregard across the sample amounts to 9% FPL in this example, the converted MAGI standard would be 109% FPL.[230]

EXAMPLE: MAGI-conversion winners

As of Nov. 2013: Joe, Sally and their two children live in the state of Westonia. Sally is the only parent working, and she makes $1000 per month. Joe recently lost his job and has an unemployment benefit of $1500 per month. He stays home with the kids, so the family has no qualified childcare disregard. After disregarding 20% of Sally's gross earned income as per current state rules in Westonia ($200), the family's effective income is $2300 (117% FPL). Under current rules, the family's income is over Westonia's § 1931 limit of 116% FPL, so neither parent is Medicaid eligible under § 1931.

In 2014: In preparation for MAGI-based eligibility, Westonia converts its § 1931 parent group to a MAGI-equivalent standard. The average disregard comes to 12% FPL, so the MAGI-converted standard becomes 116% + 12% = 128% FPL. The family's MAGI-based income is $2500 (127% FPL.) Joe and Sally have become eligible as § 1931 parents and will receive traditional state plan Medicaid benefits.[231]

EXAMPLE: MAGI-conversion losers

As of Nov. 2013: Enoch, his wife Susannah and his two children also live in the state of Westonia. In this case, both parents work and together they earn $2800/month (143% FPL). Westonia's § 1931 Parent eligibility is 116% FPL, but state rules allow Enoch and Susannah to disregard 20% of their gross earned income ($560) and $400 per month for childcare for their two children. Their countable income is thus $1840, or 94% FPL, and they are both currently eligible for Medicaid.

In 2014: When MAGI rules go into effect, Westonia's converted § 1931 standard will be 128% FPL (using the above example). Unfortunately, Enoch and Susannah are no longer allowed to disregard any childcare expenses or earned income, so their MAGI-based income is 138% FPL (143% - 5% FPL standard MAGI disregard.)[232] Both parents will lose their Medicaid eligibility, though they will qualify for tax credits to pay for coverage on Westonia's Health Marketplace.[233]

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[229] To better understand why this method was selected and how the calculations were performed, *see* ASPE, Research Brief, *Modified Adjusted Gross Income (MAGI) Income Conversion Methodologies* (Mar. 1, 2013), *available at* http://aspe.hhs.gov/health/reports/2013/MAGIConversions/rb.pdf.

[230] The 5% FPL standard MAGI disregard is not part of the MAGI-conversion process.

According to CMS' timeline, CMS was supposed to issue final approval of the conversion plans, including any alternative state plans, by June 15, 2013. While it appears that deadline was not met for many states, CMS has now posted most states' MAGI conversion plan and results on the Medicaid.gov website.[234] Advocates may want to confirm the accuracy of these posted documents directly with their state, as there have been discrepancies in some cases. Presumably CMS will have approved and posted all state MAGI conversion plans before January 2014.

EXAMPLE: MAGI Conversion and Working Parents in Non-Expansion States

Leticia, Julio and their daughter live in the state of South Ebida. Together the parents make just $800/month (49% FPL). State Medicaid rules allow them to disregard the first $200 of earned income plus half of the remainder ($300). Their effective income is thus $800 - $200 - $300= $300/month, just under South Ebida's threshold for a family of three, which is 19% FPL ($303/month).

In 2014: Once MAGI-based rules go into effect, the relevant eligibility thresholds will change. Assume that MAGI conversion raises the South Ebida's § 1931 eligibility from 19% to 39% FPL. Unfortunately, under MAGI rules Leticia and Julio can no longer disregard such a large portion of their earned income. The state has decided not to implement adult Medicaid expansion. The standard 5% FPL MAGI income disregard applies because the parents' Medicaid eligibility hangs in the balance. This gets them from 49% FPL down to 44%, which is still too high to qualify under South Ebida's MAGI-converted standard (39%).

Leticia and Julio will lose Medicaid eligibility in 2014. Because they make less than 100% FPL, they will not qualify for subsidies on South Ebida's health insurance exchange either.

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[231] For this family, the 5% FPL standard MAGI disregard would not apply because it is not needed to make them eligible.

[232] Childcare expenses count towards MAGI income except for expenses paid through an employer-sponsored childcare flexible spending arrangement (FSA). Access to an FSA is rare for lower-income employees.

[233] The 5% FPL standard MAGI disregard only applies to Medicaid eligibility, so for the purposes of the Marketplace this family's income would be 143% FPL.

[234] CMS, *State Medicaid & CHIP Policies for 2014* (Oct. 2013), http://medicaid.gov/Medicaid-CHIP-Program-Information/By-State/By-State.html.

VII. Applicable Federal Poverty Levels

Once the composition and number of the household and the amount of modified adjusted gross income are determined, the MAGI amount is compared to the relevant eligibility limit which is based on the Federal Poverty Level ("FPL") for the particular household size. For example, the MAGI for a single non-pregnant, non-disabled adult applying for Medicaid coverage in an expansion state would be compared to 138% FPL (i.e., the 133% limit plus the 5% income disregard); if the MAGI is at or lower than 138%, then the individual is eligible. For other eligibility categories, there will be MAGI-converted amounts, particular to each state, that will be the limits for eligibility.

Note, however, that the FPLs are updated and changed every year, so that it is necessary to know which year's FPLs are being used for an eligibility determination. The new annual FPLs are published early in each calendar year; for example, the 2014 FPLs were published in the Federal Register on January 22, 2014.[235] Because the rules for determining which FPL to use differ between Medicaid/CHIP and the marketplaces, there may be different sets of FPLs in use at the same time for the different insurance affordability programs during certain times of the year.

For the marketplaces, FPL is defined as "the most recently published Federal poverty level, updated periodically in the Federal Register by the Secretary of Health and Human Services under the authority of 42 U.S.C. 9902(2), as of the first day of the annual open enrollment period for coverage in a QHP through the Exchange, as specified in § 155.410."[236] That section sets the initial open enrollment period to begin on October 1, 2013, and subsequent annual enrollment periods to begin on October 15 of each year, though CMS has announced that the beginning of the next open enrollment period will be delayed until November 15, 2014. Thus, eligibility for APTCs will be determined based on the 2013 FPLs (which were in effect on October 1, 2013) presumably until November 15, 2014, at which point the 2014 FPLs will start to be used.

For Medicaid and CHIP, FPL is defined as "the Federal poverty level updated periodically in the Federal Register by the Secretary of Health and Human Services under the authority of 42 U.S.C. 9902(2), as in effect for the applicable budget period used to determine an individual's eligibility in accordance with § 435.603(h) of this part."[237] While this might indicate that the new FPLs for Medicaid/CHIP go into effect almost immediately after being published, in fact there has always been some delay before states update their IT systems to incorporate the new FPLs. (For example, California has usually not implemented the updated FPLs until April each year.) For 2014, CMS has stated that it is updating the Federally-Facilitated Marketplace systems on February 10, 2014 to reflect the new FPLs for Medicaid and CHIP.

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[235] 79 Fed. Reg. 3594.
[236] 42 C.F.R. § 155.300(a).
[237] 42 C.F.R. § 435.4.

Regardless of any delay, the most current FPLs will be put into use for Medicaid at some point during the early part of each year for Medicaid, while the FPLs from the prior year, that were in effect on the first day of open enrollment for the marketplaces, will still be in use for determinations of APTC eligibility. Thus, for a substantial part of the year, two different sets of FPLs will be in use.

VIII. State Options for the Transition to MAGI-based Eligibility Systems

In May 2013 guidance, CMS outlined five targeted enrollment strategies for states designed to streamline the administration of eligibility determinations.[238] Two of these five strategies relate directly to the transition to MAGI-based methodologies:

- Implementing MAGI-based methodologies before January 1, 2014 through § 1115 demonstration;
- Delaying or rescheduling current beneficiary redeterminations until after March 31, 2014.

Both of these time-limited options attempt to address the problem of running two eligibility determinations at the same time during the transition to MAGI. Starting October 1, individuals began applying for coverage using MAGI-based methodologies for all insurance affordability programs, though coverage through QHPs or Medicaid expansion begins January 1. Prior to 2014, states also have to evaluate new applicants for eligibility based on current Medicaid rules to see if they could access Medicaid or CHIP coverage right away. Similarly, state Medicaid agencies need to conduct eligibility redeterminations using both MAGI-based and pre-MAGI income counting rules during the transition period.

After January 1, pre-MAGI household composition and income counting rules will no longer apply (for applicable categories subject to MAGI), so the transition to MAGI will be complete for new applicants. However, eligibility redeterminations will still require pre-MAGI rules. This is because the statute requires states to allow current beneficiaries who lose eligibility solely due to the transition to MAGI to retain their eligibility through March 31, 2014 or the date of their next scheduled redetermination, whichever is later.[239] The only way to identify such individuals is to compare the results from both current and MAGI-based eligibility methodologies. Thus, absent any use of CMS options, states must use both eligibility systems simultaneously from October 1, 2013 through at least March 31, 2014. However, states that implement these two time-limited options, independently or together, can limit or even eliminate the period during which both eligibility systems would overlap.

A. Early MAGI implementation

Under this option, states may implement MAGI-based methodologies beginning October 1, 2013. In such states, current income counting rules would no longer apply for new applicants. Those individuals eligible for existing categories (converted to a MAGI-equivalent income threshold) may access coverage immediately, while those

[238] CMS, *Dear State Health Official & State Medicaid Director* (May 17, 2013) (Facilitating Medicaid and CHIP Enrollment and Renewal in 2014).
[239] 42 U.S.C. § 1396a(e)(14)(D)(v); 42 C.F.R. § 435.603(a)(3).

eligible under am ACA Medicaid expansion category have to wait until January 1, 2014 to gain coverage.[240] States implement this option through § 1115 demonstration authority. CMS offered an expedited request and approval process for states with existing § 1115 demonstrations, while states with no such demonstrations had to conform to the standard transparency and stakeholder participation requirements. As of September 2013, CMS approved 14 states plus the District of Columbia to implement early MAGI.[241]

Importantly, this option alone does not completely eliminate the need to apply both eligibility systems simultaneously during the transition to MAGI. Early MAGI states still have to apply current eligibility rules for existing beneficiaries renewing their eligibility to determine who loses eligibility solely because of the transition to MAGI. To address redeterminations, states have to use the second option.

B. Delaying and rescheduling eligibility redeterminations

This option allows states to delay regularly scheduled Medicaid redeterminations that would otherwise occur in the first three months of 2014.[242] This eliminates the need to identify individuals who lose eligibility solely due to the transition to MAGI-based methodologies by temporarily extending eligibility for everyone until after March 31. Consequently, participating states could dispense with pre-MAGI eligibility systems as early as January 1, when MAGI-based enrollment coverage begins. CMS will work with participating states to develop reasonable approaches to rescheduling redeterminations so they remain relatively evenly distributed throughout the year.

Authority for this option stems from statutory language allowing HHS to waive Medicaid and CHIP provisions "as are necessary to ensure that States establish income and eligibility determination systems that protect beneficiaries."[243] Because the statute does not specify any public process requirements, HHS developed a streamlined approval process for states to request such waivers.

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[240] Relevant expansions include coverage for children 6-19 to 133% FPL, adults 19-64 to 133% FPL, and certain adolescents who age out of foster care.

[241] Colorado, the District of Columbia, Hawaii, Illinois, Kansas, Louisiana, Missouri, Nevada, New Jersey, Oklahoma, Oregon, Pennsylvania Virginia, Washington, and West Virginia were scheduled to implement early MAGI on October 1, 2013. CMS, *Targeted Enrollment Strategies* (Oct. 2013), http://medicaid.gov/AffordableCareAct/Medicaid-Moving-Forward-2014/Targeted-Enrollment-Strategies/targeted-enrollment-strategies.html.

[242] This delay applies to regularly scheduled determinations. Enrollees who report a change in circumstance during this period would still be protected under 42 U.S.C. § 1396a(e)(14)(D)(v). That provision requires states to identify enrollees who lose coverage due solely to MAGI and extend their coverage until at least March 31, 2014. States will need to redetermine any individual who reports a change in circumstance using both pre-MAGI and MAGI income rules to identify: 1) if she will remain eligible under MAGI; and 2) if not, whether her ineligibility is due to the MAGI transition (and not just her change in circumstance).

[243] 42 U.S.C. § 1396a(e)(14)(A).

Current guidance does not clearly indicate whether states that implement MAGI early will also be able to delay redeterminations scheduled between October 1, 2013 and January 1, 2014.

C. Eligibility for Transitional Medical Assistance (TMA)

TMA allows § 1931 parents and caretakers to extend their eligibility after becoming ineligible due to an increase in employment hours, earned income or child/spousal support payments. Current law requires states to offer at least six months of extended eligibility for anyone who was Medicaid eligible for at least three of the previous six months, though many states have taken up the option to extend coverage to 12 months or even longer.

The structure of TMA will change with the transition to MAGI. First, MAGI will no longer include child support as countable income, so that pathway for receiving TMA will no longer apply. Furthermore, the statute authorizing extended TMA, 42 U.S.C. § 1396r-6, sunsets at the end of 2013.[244] If Congress fails to extend it, a different section, 42 U.S.C. § 1396a(e)(1)(A), will control and it requires only four months of transitional coverage. CMS has not clarified whether all or some subset of individuals who lose their eligibility due to the transition to MAGI-based methodologies will qualify for TMA.

[244] 42 U.S.C. § 1396r-6(f).

IX. MAGI and the Single Streamlined Application

As noted, the ACA requires all states to implement a Single Streamlined Application for all IAPs. States may adopt the federal model application, or develop their own, subject to HHS approval. The single application is used for multiple IAPs, including Medicaid, CHIP, and APTC/CSRs in the Marketplaces. States can also use the Single Streamlined Application for other public benefits programs, such as SNAP.

All members of a household can apply for all IAPs on the same application. The Single Streamlined Application must be offered in multiple formats, including online, paper, and over the telephone.[245]

The Single Streamlined Application implements the ACA's "no wrong door" policy that aims to allow individuals to apply at a Marketplace, Medicaid or CHIP agency without being turned away.

The Application features questions and data points to identify MAGI income, as well as the composition of the Medicaid and Marketplace households. Updated state eligibility systems are designed to conduct an initial MAGI screening to determine an applicant's eligibility for APTCs/CSRs in the Marketplace and for MAGI-based Medicaid/CHIP eligibility.

The applications also include questions to help identify those who may be eligible for Medicaid on a basis other than MAGI. These include questions about disabilities, as well as questions asking if any applicant requires assistance with activities of daily living.

The ACA requires states to leverage and maximize electronic data sources to verify information provided on the application.[246] Paper documentation is to be used as a last resort.

[245] 45 C.F.R. § 155.405.
[246] 45 C.F.R. § 155.320.

X. Appendices

Appendix A. Medicaid Eligibility Categories and Populations Subject to MAGI

Medicaid Eligibility Categories and Populations Subject to MAGI	
Category	**Medicaid Act citation: 42 U.S.C.**
Non-disabled, non-elderly adults	18-64 (ACA expansion) - • § 1396a(10)(A)(i)(VIII)
Most children	• Low-income children in TANF - § 1396u–1 • Mandatory poverty level children age 1-5 - § 1396a(10)(A)(i)(VI) • Qualified Children – § 1396a(10)(A)(i)(III) • Mandatory poverty-level infants - 42 U.S.C. § 1396a(10)(A)(i)(IV) • Mandatory poverty-level children age 6-18 - 42 U.S.C. § 1396a (10)(A)(i)(VII) • Optional institutionalized children – § 1396a(10)(A)(ii)(IV)[247] • Optional poverty level infants – § 1396a(10)(A)(ii)(IX) • Optional poverty level children under 19
Pregnant women	• Qualified Pregnant Women - § 1396a(a)(10)(A)(i)(III) • Mandatory poverty level pregnant women - § 1396a(a)(10)(A)(i)(IV) • Optional poverty level pregnant women § 1396a(a)(10)(A)(ii)(X) • AFDC criteria pregnant women – § 1396a(a)(10)(A)(ii)(I) • Institutionalized pregnant women – § 1396a(a)(10)(A)(ii)(IV)
Parents and caretaker relatives	§ 1396u–1
Independent foster care adolescents (optional)	§ 1396a(a)(10)(A)(ii)(XVII)
State adoption assistance agreements (optional)	§ 1396a(a)(10)(A)(ii)(XVIII)
Limited scope Medicaid –TB	§ 1396a(z)
Family Planning	§ 1396a(a)(10)(A)(ii)(XXI) § 1396a(ii) § 1396a(a)(10)(G)(XVI)(XVI)
CHIP	§ 1397aa

[247] "Institutionalized children" refers to children who would be eligible under AFDC levels if they were not institutionalized (*see* 42. C.F.R. 435.211). CMS consolidated this and other children's eligibility categories under 42 C.F.R. § 435.118 (*see* 77 Fed. Reg. 17205).

Appendix B. ACA MAGI Exceptions

ACA MAGI Exceptions	
Medicaid Act citation: 42 U.S.C.	**Category or population**
§ 1396a(e)(14)(D)(i)(I)	Persons eligible under state plan or waiver where state does not conduct an income determination **Examples:** • SSI recipients (where states automatically provide Medicaid because of SSI) • Children IV-E foster care
§ 1396a(e)(14)(D)(i)(II)	Individuals who have attained age 65 (where age is a condition of eligibility)
§ 1396a(e)(14)(D)(i)(III)	People who qualify for state plan or waiver program on the basis of disability regardless of SSI; **Example:** • Medicaid recipients in 209(b) states that do not rely on SSI determinations when determining eligibility Individuals who would be eligible for SSI (and thus Medicaid) if they were not institutionalized. **Example:** • Katie Beckett option
§ 1396a(e)(14)(D)(i)(IV)	Medically needy
§ 1396a(e)(14)(D)(i)(V)	QMBys SLMBys QIs
§ 1396a(e)(14)(D)(ii)	Express Lane Agency findings under state plan or waiver
§ 1396a(e)(14)(D)(iii)	Medicare subscription drug subsidies
§ 1396a(e)(14)(D)(iv)	Long term care determinations
§ 1396a(e)(14)(F)	Limited HHS authority to waive MAGI for certain dually eligible individuals to facilitate coordination

Appendix C. Populations and Eligibility Categories Where MAGI Does Not Apply

Populations and Eligibility Categories Where MAGI Does Not Apply	
Eligibility category	**Medicaid Act citation: 42 U.S.C.**
Early adult expansions (but no asset test)	§ 1396a(k)(2)
Adults 65 and over	Mandatory: (receiving state supplements) § 1396a Optional coverage: 1396d(a)(iii) Individuals eligible for assistance except for institutional status: § 1369a(a)(10)(A)(ii)(IV); § 1396b(f)(4)(C)
Persons eligible due to disability	Mandatory: (receiving state supplements) § 1396a Qualified Severely Impaired Individuals (Section 1619), § 1396a(a)(10)(A)(i)(II) Qualified Disabled and Working Individuals: § 1396a(10)(E(ii) Grandfathered 1973 recipients: § 1396a Disabled Adult Children who lost SSI benefits: § 1383(c) Optional disability coverage: § 1396d(a)(v)-(vii); Working-disabled individuals: Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-107 § 201, 113 Stat. 1860, 1891 (1999). Medically improved working disabled individuals: § 1396a(a)(10)(A)(ii)(XVI); § 1396d(v)
SSI recipients	§ 1396a(a)(1)(A)(i)(II)
Individuals aging out of foster care (new ACA mandatory category	§ 1396a(a)(10)(A)(i)(IX)

Populations and Eligibility Categories Where MAGI Does Not Apply	
Eligibility category	**Medicaid Act citation: 42 U.S.C.**
209(b) state eligibility determinations	§ 1396a(f)
Long term care patients (both community-based and institutional)	
Breast and Cervical Cancer Program (no Medicaid income determination necessary)	§ 1396a(a)(10)(A)(ii)(XVIII); § 1396a(aa)
Medically Needy (but with some CMS options to use MAGI)	§ 1396a(a)(10)(C)(i); § 1396a(a)(17)
Children in foster care and Title IV-E adoption assistance	§ 1396a(a)(10)(A)(i)(I)
Individuals for whom Medicaid is paying Medicare cost sharing (QMBYs, SLMBYs and QI)	§ 1396a(a)(10)(E) § 1396d(p) § 1396a(a)(10)(E)(iii) § 1396u-3(b)
Individuals determined eligible through Express Lane Eligibility	§ 1396a(a)(14)
Medicare prescription drug subsidies	§ 1395w-114
Newborns born to women who are eligible to receive Medicaid (for one year)	§ 1396a(e)(4)
Post-eligibility income disregards (hospice, institutionalized individuals, HCBS waivers)	§ 1396a(r); § 1396a(o)

Appendix D. IRS Form 1040

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2013** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space

For the year Jan. 1–Dec. 31, 2013, or other tax year beginning , 2013, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		Presidential Election Campaign: Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/state/county / Foreign postal code	

Filing Status Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

c **Dependents:** (1) First name / Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

d Total number of exemptions claimed

Boxes checked on 6a and 6b
No. of children on 6c who:
• **lived with you**
• **did not live with you due to divorce or separation (see instructions)**
Dependents on 6c not entered above
Add numbers on lines above ▶

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7	
8a	**Taxable** interest. Attach Schedule B if required		8a	
b	**Tax-exempt** interest. **Do not** include on line 8a	8b		
9a	Ordinary dividends. Attach Schedule B if required		9a	
b	Qualified dividends	9b		
10	Taxable refunds, credits, or offsets of state and local income taxes		10	
11	Alimony received		11	
12	Business income or (loss). Attach Schedule C or C-EZ		12	
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13	
14	Other gains or (losses). Attach Form 4797		14	
15a	IRA distributions 15a	b Taxable amount	15b	
16a	Pensions and annuities 16a	b Taxable amount	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17	
18	Farm income or (loss). Attach Schedule F		18	
19	Unemployment compensation		19	
20a	Social security benefits 20a	b Taxable amount	20b	
21	Other income. List type and amount		21	
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22	

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27		
28	Self-employed SEP, SIMPLE, and qualified plans	28		
29	Self-employed health insurance deduction	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid b Recipient's SSN ▶	31a		
32	IRA deduction	32		
33	Student loan interest deduction	33		
34	Tuition and fees. Attach Form 8917	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35		36	
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37	

Tax and Credits

38	Amount from line 37 (adjusted gross income)		38	
39a	Check if: ☐ You were born before January 2, 1949, ☐ Blind. ☐ Spouse was born before January 2, 1949, ☐ Blind. } Total boxes checked ▶ 39a			
b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ 39b ☐			
40	**Itemized deductions** (from Schedule A) **or your standard deduction** (see left margin)		40	
41	Subtract line 40 from line 38		41	
42	**Exemptions.** If line 38 is $150,000 or less, multiply $3,900 by the number on line 6d. Otherwise, see instructions		42	
43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43	
44	**Tax** (see instructions). Check if any from: a ☐ Form(s) 8814 b ☐ Form 4972 c ☐		44	
45	**Alternative minimum tax** (see instructions). Attach Form 6251		45	
46	Add lines 44 and 45 ▶		46	
47	Foreign tax credit. Attach Form 1116 if required	47		
48	Credit for child and dependent care expenses. Attach Form 2441	48		
49	Education credits from Form 8863, line 19	49		
50	Retirement savings contributions credit. Attach Form 8880	50		
51	Child tax credit. Attach Schedule 8812, if required	51		
52	Residential energy credits. Attach Form 5695	52		
53	Other credits from Form: a ☐ 3800 b ☐ 8801 c ☐	53		
54	Add lines 47 through 53. These are your **total credits**		54	
55	Subtract line 54 from line 46. If line 54 is more than line 46, enter -0- ▶		55	

Standard Deduction for—
- People who check any box on line 39a or 39b or who can be claimed as a dependent, see instructions.
- All others: Single or Married filing separately, $6,100; Married filing jointly or Qualifying widow(er), $12,200; Head of household, $8,950

Other Taxes

56	Self-employment tax. Attach Schedule SE	56	
57	Unreported social security and Medicare tax from Form: a ☐ 4137 b ☐ 8919	57	
58	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	58	
59a	Household employment taxes from Schedule H	59a	
b	First-time homebuyer credit repayment. Attach Form 5405 if required	59b	
60	Taxes from: a ☐ Form 8959 b ☐ Form 8960 c ☐ Instructions; enter code(s)	60	
61	Add lines 55 through 60. This is your **total tax** ▶	61	

Payments

If you have a qualifying child, attach Schedule EIC.

62	Federal income tax withheld from Forms W-2 and 1099	62		
63	2013 estimated tax payments and amount applied from 2012 return	63		
64a	**Earned income credit (EIC)**	64a		
b	Nontaxable combat pay election 64b			
65	Additional child tax credit. Attach Schedule 8812	65		
66	American opportunity credit from Form 8863, line 8	66		
67	Reserved	67		
68	Amount paid with request for extension to file	68		
69	Excess social security and tier 1 RRTA tax withheld	69		
70	Credit for federal tax on fuels. Attach Form 4136	70		
71	Credits from Form: a ☐ 2439 b ☐ Reserved c ☐ 8885 d ☐	71		
72	Add lines 62, 63, 64a, and 65 through 71. These are your **total payments** ▶		72	

Refund

Direct deposit? See instructions.

73	If line 72 is more than line 61, subtract line 61 from line 72. This is the amount you **overpaid**		73	
74a	Amount of line 73 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐		74a	
b	▶ Routing number ▶ c Type: ☐ Checking ☐ Savings			
d	▶ Account number			
75	Amount of line 73 you want **applied to your 2014 estimated tax** ▶	75		

Amount You Owe

76	**Amount you owe.** Subtract line 72 from line 61. For details on how to pay, see instructions ▶		76	
77	Estimated tax penalty (see instructions)	77		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ | Phone no. ▶ | Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

Appendix E. The Marketplace and Medicaid/CHIP Household

The Marketplace and Medicaid/CHIP Household		
Individual seeking an eligibility determination	**Household**	**Regulation citation: 42 C.F.R.**
1. Tax filers: An individual who is a tax filer who claims a personal exemption and is not claimed as a dependent by someone else	The individual's Medicaid/CHIP household is the same as the Marketplace household, consisting of: • The tax filer(s) • Claimed dependents	§ 435.603(f)(1)
2. Tax dependents: An individual who is claimed as a tax dependent by someone else (and does not fall into an exception)	The individual's Medicaid/CHIP household is the same as the Marketplace household, consisting of: • The individual who is claimed as a dependent • The tax filer(s) • Other dependents claimed by the tax filer(s)	§ 435.603(f)(2)
***Exception A*:** An individual who is claimed as a tax dependent by someone else but is not a child or a spouse of the tax filer (e.g., a grandmother who is low income and living with the family). Use the rules for non-filers.	The individual's Marketplace household consists of the tax filer and all dependents claimed by the filer, including the individual seeking an eligibility determination. The individual's Medicaid/CHIP household consists of: • The individual seeking an eligibility determination who is claimed as a dependent by a tax filer • The individual's spouse if living with the individual • The individual's children if living with the individual and who meet the state's age requirements • The individual's siblings if living with the individual, but only if the individual is under the age specific by the state • The individual's parents if living with the individual, but only if the individual is under the age specified by the state	§ 435.603(f)(2)(i) § 435.603(f)(3)

The Marketplace and Medicaid/CHIP Household		
Individual seeking an eligibility determination	**Household**	**Regulation citation: 42 C.F.R.**
***Exception B*:** A child who is under the age specified by the state, and who lives with both parents, but where only one parent claims the child as a tax dependent. Use the rules for non-filers.	The child's Marketplace household consists of the child, the parent who claims the child as a tax dependent, and any other tax dependents who are claimed by the parent. The child's Medicaid/CHIP household consists of: • The child • Both of the child's parents who are living with the child • The child's children if living with the applicant and meeting the state's age requirements • The child's siblings if living with the applicant and meeting the state's age requirements	§ 435.603(f)(2)(ii) § 435.603(f)(3)
***Exception C*:** A child who is under the age established by the state, and who lives with a custodial parent, but who is claimed as a tax dependent by the non-custodial parent. Use the rules for non-filers.	The child's Marketplace household consists of the child, the non-custodial parent who claims the child as a tax dependent, and any other tax dependents who are claimed by the parent. The child's Medicaid/CHIP household consists of: • The child • The custodial parent living with the individual • The child's children if living with the child and meeting the state's age requirements • The child's siblings, if they live with the child and meet the state's age requirements	§ 435.603(f)(2)(iii) § 435.603(f)(3)
***3. Non-filers and non-dependents*:** An individual who does not file a federal tax return and who is not claimed as a dependent by someone else.	There is no Marketplace household for individuals who do not file taxes or who are not claimed as a tax dependent. The individual's Medicaid/CHIP household consists of: • The individual • The individual's spouse if living with the individual • The individual's children if living with the individual and meeting the state's age requirements • The individual's siblings if living with the individual and meeting the state's age requirements, but only if the individual meets the state's age eligibility requirements • The individual's parents if living with the individual, but only if the individual meets the state's age eligibility requirements	§ 435.603(f)(3)

Appendix F. Household Composition Quick Reference

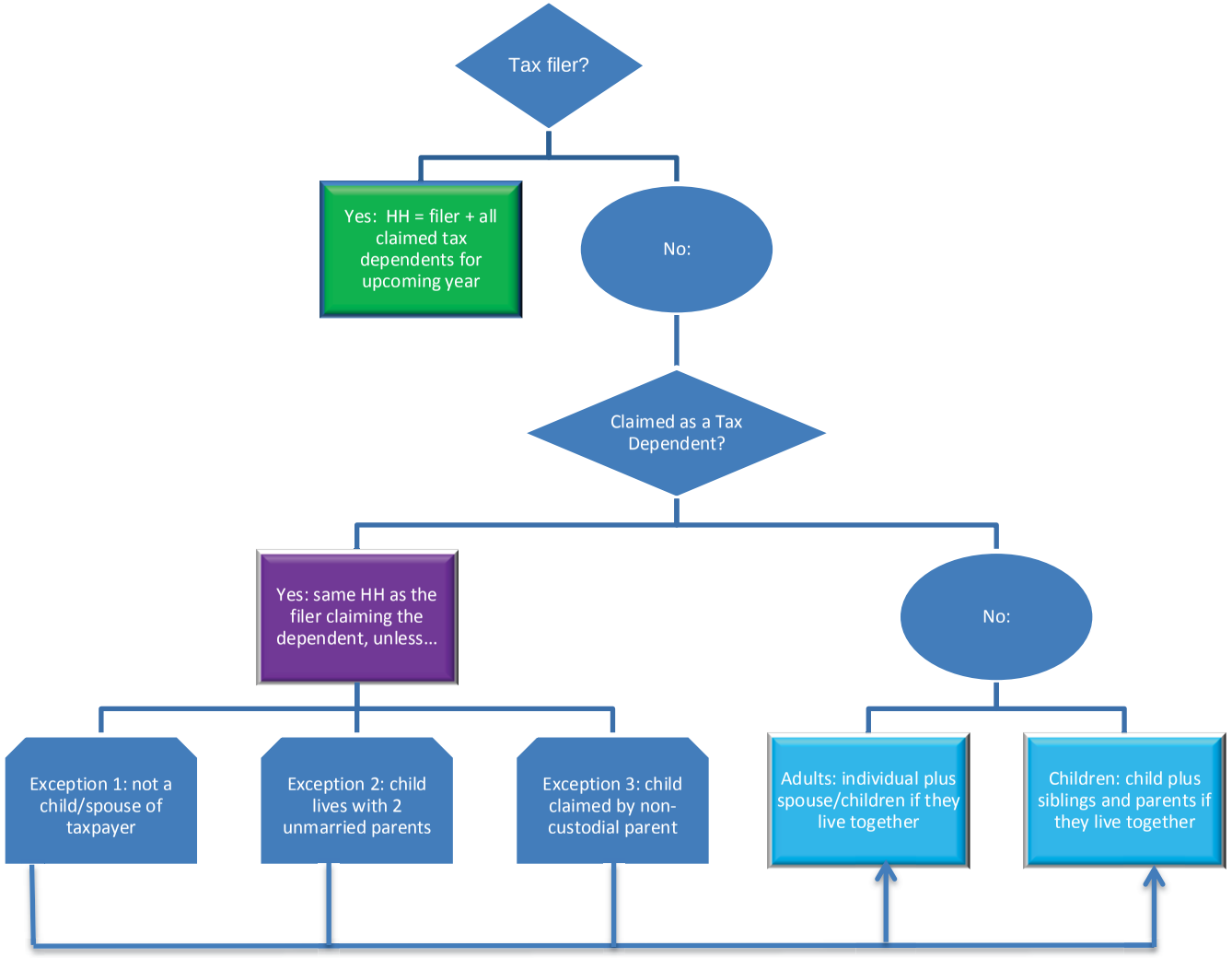
MAGI Household Composition

1. Marketplace Household	2. Medicaid household	3. Rules for non-filers/non-dependents *(also applies to dependent relatives and child claimed by one parent)*

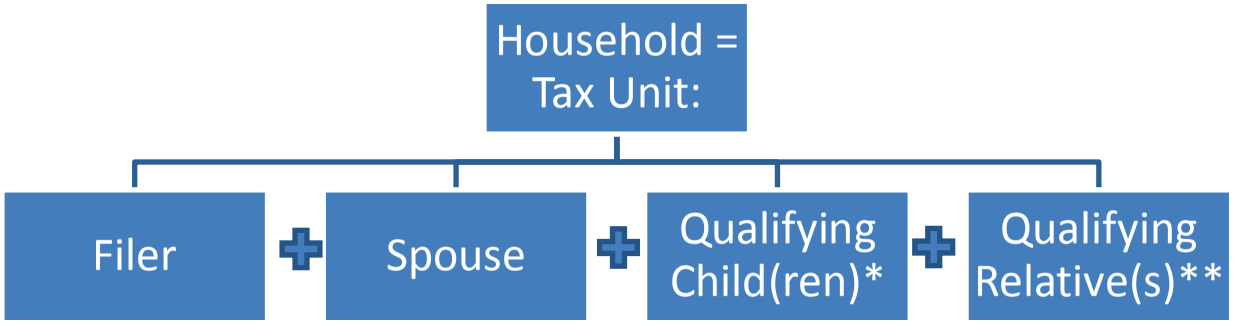
General rule: Marketplace household = **tax filer(s) + dependents**
 	
• **Tax filer(s)**
  ➢ Includes spouses filing jointly
• **Dependents**
  ➢ Qualifying Child
  ➢ Qualifying Relative
• Not lawfully present excluded
• Married couples must file jointly to be eligible for APTCs/CSRs
• Same sex marriages are recognized
• Household is the same for every member
	General rule: The Medicaid household is the same as the Marketplace household = **tax filer(s) + dependents**
	
	1. **Who is seeking an eligibility determination?**
	2. **Is this person a tax filer or claimed as a dependent?**
	  ➢ If neither, apply the special rules for non-filers/non-dependents
	3. **If a dependent, do any exceptions apply?**
	  ▪ Dependent relatives (someone other than a spouse or a child of the tax filer)
	  ▪ Children claimed by only one parent (including non-custodial parent)
	  ➢ If yes, use the rules for non-filers/non-dependents
	4. **Married couples filing separately**
	  ▪ They are in the same Medicaid household if they live together
	5. **Same sex marriages**
	  ➢ Medicaid programs can decide whether to recognize them
	6. **Pregnant women**
	  ▪ Counted as one plus the number of babies expected when she seeks an eligibility determination
	  ▪ At state option, counted as one, two, or one plus the number of babies when she is in the household of someone else seeking an eligibility determination
		For **adults**, the Medicaid household consists of:
		• The individual;
		• The individual's spouse if living with the individual;
		• The individual's children* if living with the individual.
		
		For **children**, the Medicaid household consists of:
		• The child;
		• The child's parent(s) if living with the child;
		• The child's sibling(s) if living with the child;
		• The child's spouse, if living with the child;
		• The child's children, if living with the child.
		
		***Child means under 19, or under 21for full time students (at state option); this applies to the child's siblings too. A child can be natural/biological, adopted, or step child.

Prepared by Meridith Sine, Public Health Intern, Pennsylvania Health Law Project (2013)

Quick Reference Guide for



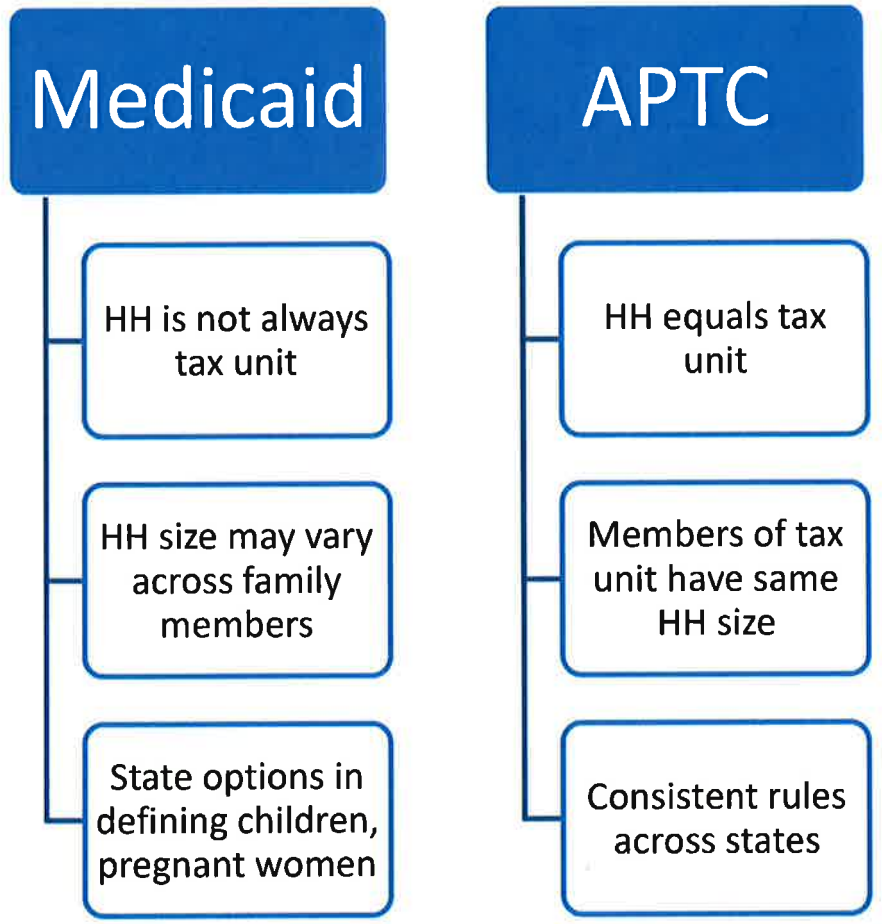
Household Size for APTC



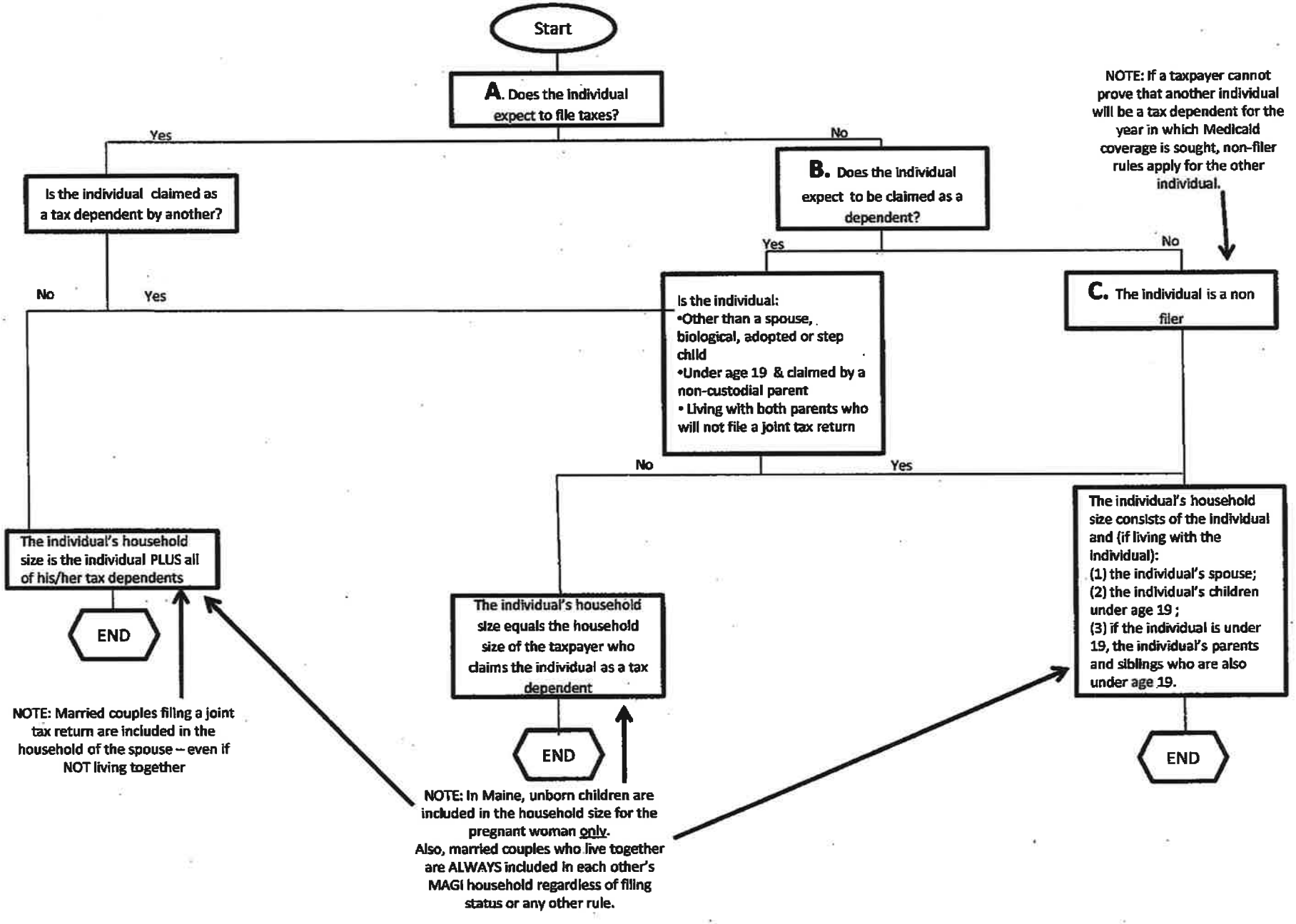
* US citizen or resident of US, Canada, or Mexico; lives with filer for more than half the year; under 19 at end of year or under 24 if a student; child doesn't provide more than half of her own support

** US citizen or resident of US, Canada, or Mexico; filer provides more than half of her support; must be related to the filer OR live in the home all year; earned less than $3,900 in 2013 (generally excludes Social Security)

Quick Comparison: Household Counting Rules



Determining MAGI Household Size



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Center for Medicaid and CHIP Services

MAGI: Medicaid and CHIP's New Eligibility Standards

Q1: What is MAGI and how is it different than the way states calculate eligibility today?

A1: It's a new, simpler way to determine eligibility for Medicaid and CHIP.

The Affordable Care Act provides a new simplified method for calculating income eligibility for Medicaid, CHIP and financial assistance available through the health insurance Marketplace. This new method calculates eligibility for all programs based on what is called modified adjusted gross income (MAGI). By using one set of income eligibility rules across all insurance affordability programs, the new law makes it easier for people to apply for health coverage through one application and enroll in the appropriate program. MAGI will replace the current process for calculating Medicaid eligibility that is in place today, which uses income deductions (known as "disregards") that are different in each state and often differ by eligibility group.

Q2: Will these new MAGI rules apply to all people applying for Medicaid?

A2: The new rules apply to most people who are eligible for Medicaid and CHIP, but not the elderly or people who qualify based on a disability.

For coverage effective January 2014, MAGI will be the basis for determining both Medicaid and CHIP eligibility for children, pregnant women, parents and the adults enrolled under the new adult eligibility group created by the ACA (in states that adopt that eligibility group). Individuals age 65 and older and those who qualify for Medicaid based on disability are not affected by the new rules.

Q3: If a state is not expanding Medicaid in 2014, does it still use MAGI rules?

A3: Yes. A state's decision whether or not to extend Medicaid coverage for low-income adults in 2014 is not related to the use of MAGI. MAGI rules simplify the eligibility rules and promote coordination between Medicaid and CHIP and coverage available through the Marketplace; coordination will be important for consumers in all states regardless of a state's decision on Medicaid eligibility for low-income adults.

Q4: Why are the new income standards higher than the old ones (even when there is no eligibility expansion)?

A4: The eligibility standards (where there's been no expansion) are not any higher than the old standards; they are expressed in a different way (gross versus net).

In the past, Medicaid and CHIP eligibility used a combination of an income eligibility standard—often expressed as a percentage of the Federal Poverty Level (FPL)—and a series of deductions (known as "disregards") that were like footnotes or 'below the line' adjustments to income and were determined by each state. The new way of calculating eligibility based on MAGI translates that two-part process into a one step process using an income standard that incorporates the 'below the line' deductions. This makes the new standard appear higher than the old one (e.g. from 185% of the FPL to 193% of the FPL for pregnant women). In effect, however, the new income standard represents what the state's old two-step process would have resulted in, just expressed in a different way.

Q5: Do the MAGI changes mean more people will be eligible for Medicaid (even when there is no eligibility expansion)?

A5: No, overall the new methodology does not change the number of people eligible for Medicaid.

The MAGI-based standard will result in approximately the same number of people being eligible under the new standard as would have been eligible under the old standard. However, there may be some differences in which people will qualify – or not qualify – depending on how they might have fared under the old system (with deductions and disregards).

Q6: Can you give an example of how the old rules work?

A6: Before MAGI, if a state's income limit was 100% of the FPL— the state would first look at the person's gross income, then subtract out (for example) 30% of their earned income and an amount they spend on childcare as work-related expense deductions and then compare that net income to 100% of the FPL. This means that under the pre-MAGI rules, in a state with an income eligibility limit of 100% of the FPL, a person with income over 100% of the FPL can qualify for Medicaid (because of the deductions and disregards).

Q7: How will the new rules work?

A7: The state will look at the individual's modified adjusted gross income, deduct 5%,which the law provides as a standard disregard, and compare that income to the new standard.

Q8: How were the new MAGI-based income standards set?

A8: Based on guidance issued in December 2012 (http://www.medicaid.gov/Federal-Policy-Guidance/downloads/SHO12003.pdf), CMS worked with states to set their new standards. Most states used a model that determines the average value of the disregards a state had in place and then added that amount to the old standard to create the new eligibility levels. In the example above, in a state with a net income standard of 100% of the FPL, if the average value of the disregards equaled 6 percentage points of the FPL, that value would be added to the old standard for a new eligibility standard of 106% of the FPL.

Q9: Will any individuals lose coverage as a result of the new income methodology?

A9: No one loses coverage as a result of converting to MAGI rules, but, in states that don't adopt the new adult eligibility group, it is possible that some individuals will lose coverage.

The Affordable Care Act ensured that no one would lose health coverage – if they were not eligible under the new MAGI standards either they would be covered under the new Medicaid adult coverage group or they would be able to purchase insurance through the Marketplace with the benefit of a premium tax credit and likely cost sharing reductions. Following the Supreme Court's decision, the Medicaid expansion is voluntary for states, and in states that do not adopt the new coverage group some individuals may lose coverage at the time of their renewal when the new rules are applied.

Q10: It looks like in some states CHIP has gotten smaller; do the new rules result in smaller CHIP programs?

A10: No, the change to MAGI does not affect the size of CHIP programs.

The number of children in CHIP does not change as a result of MAGI because the new standards have the same value as the old standards; they simply translate the state's pre-MAGI two-step policies into a simpler one-step calculation. For example, if the state under old rules covers children in Medicaid with incomes up to 150% of the Federal Poverty Limit (FPL) and CHIP from 150% to 200% of the FPL, and under MAGI the new Medicaid income standard is 160% of the FPL, that doesn't mean that children between 150% and 160% are losing CHIP coverage —it means that many children between 150% and 160% of the FPL using net income standards were already eligible for Medicaid because of the use of disregards.

Q11: Do the new standards mean that more children will move from CHIP to Medicaid?

A11: No, the number of children moving from CHIP to Medicaid is not affected by the change to MAGI.

Under the law, those states that cover children ages 6- 18 with incomes between 100% and 133% of the FPL in CHIP will be transitioning these children to Medicaid so that children under 133% of the FPL, regardless of their age, are eligible for the same coverage program (some states will continue to have different, higher income standards for younger children). The change to MAGI standards does not change the number of children who will move from CHIP to Medicaid.

Q12: Can states that want to have one eligibility level for children, ages 1- 18, do so?

A12: Yes. The new converted standards are based on the state's current income eligibility standards and their pre-2014 disregards. So if children in different age groups have different effective eligibility levels under a state's pre-2014 rules, the children will have different converted standards. For example, if a state has been covering children aged 1-5 to 133% FPL and children aged 6-18 to 100% FPL, the state's MAGI eligibility standard in 2014 may be 139% FPL for children aged 1-5 and 133% FPL for children older children.

States have the opportunity to even out their eligibility standards by changing their income eligibility standards for older children to match the standard for the younger group until December 31, 2013. CMS is happy to work with states to achieve a greater level of simplification.

Q13: Can states that want to have a "rounded" number for their eligibility standards do so or must they stay with the converted standards?

A13: Yes, states can adjust their standards within certain limits established by law.

States can adjust both their adult standards (e.g., for pregnant women) and their children standards, as long as they do not reduce eligibility levels below minimum standards established by the law. CMS can advise states of their options.

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Title 26 - INTERNAL REVENUE CODE
Subtitle A - Income Taxes
CHAPTER 1 - NORMAL TAXES AND SURTAXES
Subchapter A - Determination of Tax Liability
PART IV - CREDITS AGAINST TAX
Subpart C - Refundable Credits
Sec. 36B - Refundable credit for coverage under a qualified health plan
From the U.S. Government Printing Office, www.gpo.gov

§36B. Refundable credit for coverage under a qualified health plan

(a) In general

In the case of an applicable taxpayer, there shall be allowed as a credit against the tax imposed by this subtitle for any taxable year an amount equal to the premium assistance credit amount of the taxpayer for the taxable year.

(b) Premium assistance credit amount

For purposes of this section—

(1) In general

The term "premium assistance credit amount" means, with respect to any taxable year, the sum of the premium assistance amounts determined under paragraph (2) with respect to all coverage months of the taxpayer occurring during the taxable year.

(2) Premium assistance amount

The premium assistance amount determined under this subsection with respect to any coverage month is the amount equal to the lesser of—

(A) the monthly premiums for such month for 1 or more qualified health plans offered in the individual market within a State which cover the taxpayer, the taxpayer's spouse, or any dependent (as defined in section 152) of the taxpayer and which were enrolled in through an Exchange established by the State under 1311 [1] of the Patient Protection and Affordable Care Act, or

(B) the excess (if any) of—

(i) the adjusted monthly premium for such month for the applicable second lowest cost silver plan with respect to the taxpayer, over

(ii) an amount equal to 1/12 of the product of the applicable percentage and the taxpayer's household income for the taxable year.

(3) Other terms and rules relating to premium assistance amounts

For purposes of paragraph (2)—

(A) Applicable percentage

(i) In general

Except as provided in clause (ii), the applicable percentage for any taxable year shall be the percentage such that the applicable percentage for any taxpayer whose household income is within an income tier specified in the following table shall increase, on a sliding scale in a linear manner, from the initial premium percentage to the final premium percentage specified in such table for such income tier:

In the case of household income (expressed as a percent of poverty line) within the following income tier:	The initial premium percentage is—	The final premium percentage is—
Up to 133%	2.0%	2.0%
133% up to 150%	3.0%	4.0%
150% up to 200%	4.0%	6.3%
200% up to 250%	6.3%	8.05%
250% up to 300%	8.05%	9.5%
300% up to 400%	9.5%	9.5%.

(ii) Indexing

(I) In general

Subject to subclause (II), in the case of taxable years beginning in any calendar year after 2014, the initial and final applicable percentages under clause (i) (as in effect for the preceding calendar year after application of this clause) shall be adjusted to reflect the excess of the rate of premium growth for the preceding calendar year over the rate of income growth for the preceding calendar year.

(II) Additional adjustment

Except as provided in subclause (III), in the case of any calendar year after 2018, the percentages described in subclause (I) shall, in addition to the adjustment under subclause (I), be adjusted to reflect the excess (if any) of the rate of premium growth estimated under subclause (I) for the preceding calendar year over the rate of growth in the consumer price index for the preceding calendar year.

(III) Failsafe

Subclause (II) shall apply for any calendar year only if the aggregate amount of premium tax credits under this section and cost-sharing reductions under section 1402 of the Patient Protection and Affordable Care Act for the preceding calendar year exceeds an amount equal to 0.504 percent of the gross domestic product for the preceding calendar year.

(B) Applicable second lowest cost silver plan

The applicable second lowest cost silver plan with respect to any applicable taxpayer is the second lowest cost silver plan of the individual market in the rating area in which the taxpayer resides which—

(i) is offered through the same Exchange through which the qualified health plans taken into account under paragraph (2)(A) were offered, and

(ii) provides—

(I) self-only coverage in the case of an applicable taxpayer—

(aa) whose tax for the taxable year is determined under section 1(c) (relating to unmarried individuals other than surviving spouses and heads of households) and who is not allowed a deduction under section 151 for the taxable year with respect to a dependent, or

(bb) who is not described in item (aa) but who purchases only self-only coverage, and

(II) family coverage in the case of any other applicable taxpayer.

If a taxpayer files a joint return and no credit is allowed under this section with respect to 1 of the spouses by reason of subsection (e), the taxpayer shall be treated as described in clause (ii)(I) unless a deduction is allowed under section 151 for the taxable year with respect to a dependent other than

either spouse and subsection (e) does not apply to the dependent.

(C) Adjusted monthly premium

The adjusted monthly premium for an applicable second lowest cost silver plan is the monthly premium which would have been charged (for the rating area with respect to which the premiums under paragraph (2)(A) were determined) for the plan if each individual covered under a qualified health plan taken into account under paragraph (2)(A) were covered by such silver plan and the premium was adjusted only for the age of each such individual in the manner allowed under section 2701 of the Public Health Service Act. In the case of a State participating in the wellness discount demonstration project under section 2705(d) of the Public Health Service Act, the adjusted monthly premium shall be determined without regard to any premium discount or rebate under such project.

(D) Additional benefits

If—

(i) a qualified health plan under section 1302(b)(5) of the Patient Protection and Affordable Care Act offers benefits in addition to the essential health benefits required to be provided by the plan, or

(ii) a State requires a qualified health plan under section 1311(d)(3)(B) of such Act to cover benefits in addition to the essential health benefits required to be provided by the plan,

the portion of the premium for the plan properly allocable (under rules prescribed by the Secretary of Health and Human Services) to such additional benefits shall not be taken into account in determining either the monthly premium or the adjusted monthly premium under paragraph (2).

(E) Special rule for pediatric dental coverage

For purposes of determining the amount of any monthly premium, if an individual enrolls in both a qualified health plan and a plan described in section 1311(d)(2)(B)(ii)(I) of the Patient Protection and Affordable Care Act for any plan year, the portion of the premium for the plan described in such section that (under regulations prescribed by the Secretary) is properly allocable to pediatric dental benefits which are included in the essential health benefits required to be provided by a qualified health plan under section 1302(b)(1)(J) of such Act shall be treated as a premium payable for a qualified health plan.

(c) Definition and rules relating to applicable taxpayers, coverage months, and qualified health plan

For purposes of this section—

(1) Applicable taxpayer

(A) In general

The term "applicable taxpayer" means, with respect to any taxable year, a taxpayer whose household income for the taxable year equals or exceeds 100 percent but does not exceed 400 percent of an amount equal to the poverty line for a family of the size involved.

(B) Special rule for certain individuals lawfully present in the United States

If—

(i) a taxpayer has a household income which is not greater than 100 percent of an amount equal to the poverty line for a family of the size involved, and

(ii) the taxpayer is an alien lawfully present in the United States, but is not eligible for the medicaid program under title XIX of the Social Security Act by reason of such alien status,

the taxpayer shall, for purposes of the credit under this section, be treated as an applicable taxpayer with a household income which is equal to 100 percent of the poverty line for a family of

the size involved.

(C) Married couples must file joint return

If the taxpayer is married (within the meaning of section 7703) at the close of the taxable year, the taxpayer shall be treated as an applicable taxpayer only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

(D) Denial of credit to dependents

No credit shall be allowed under this section to any individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins.

(2) Coverage month

For purposes of this subsection—

(A) In general

The term "coverage month" means, with respect to an applicable taxpayer, any month if—

(i) as of the first day of such month the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer is covered by a qualified health plan described in subsection (b)(2)(A) that was enrolled in through an Exchange established by the State under section 1311 of the Patient Protection and Affordable Care Act, and

(ii) the premium for coverage under such plan for such month is paid by the taxpayer (or through advance payment of the credit under subsection (a) under section 1412 of the Patient Protection and Affordable Care Act).

(B) Exception for minimum essential coverage

(i) In general

The term "coverage month" shall not include any month with respect to an individual if for such month the individual is eligible for minimum essential coverage other than eligibility for coverage described in section 5000A(f)(1)(C) (relating to coverage in the individual market).

(ii) Minimum essential coverage

The term "minimum essential coverage" has the meaning given such term by section 5000A(f).

(C) Special rule for employer-sponsored minimum essential coverage

For purposes of subparagraph (B)—

(i) Coverage must be affordable

Except as provided in clause (iii), an employee shall not be treated as eligible for minimum essential coverage if such coverage—

(I) consists of an eligible employer-sponsored plan (as defined in section 5000A(f)(2)), and

(II) the employee's required contribution (within the meaning of section 5000A(e)(1)(B)) with respect to the plan exceeds 9.5 percent of the applicable taxpayer's household income.

This clause shall also apply to an individual who is eligible to enroll in the plan by reason of a relationship the individual bears to the employee.

(ii) Coverage must provide minimum value

Except as provided in clause (iii), an employee shall not be treated as eligible for minimum essential coverage if such coverage consists of an eligible employer-sponsored plan (as defined in section 5000A(f)(2)) and the plan's share of the total allowed costs of benefits provided under the plan is less than 60 percent of such costs.

(iii) Employee or family must not be covered under employer plan

Clauses (i) and (ii) shall not apply if the employee (or any individual described in the last sentence of clause (i)) is covered under the eligible employer-sponsored plan or the grandfathered health plan.

(iv) Indexing

In the case of plan years beginning in any calendar year after 2014, the Secretary shall adjust the 9.5 percent under clause (i)(II) in the same manner as the percentages are adjusted under subsection (b)(3)(A)(ii).

(D) Exception for individual receiving free choice vouchers

The term "coverage month" shall not include any month in which such individual has a free choice voucher provided under section 10108 of the Patient Protection and Affordable Care Act.

(3) Definitions and other rules

(A) Qualified health plan

The term "qualified health plan" has the meaning given such term by section 1301(a) of the Patient Protection and Affordable Care Act, except that such term shall not include a qualified health plan which is a catastrophic plan described in section 1302(e) of such Act.

(B) Grandfathered health plan

The term "grandfathered health plan" has the meaning given such term by section 1251 of the Patient Protection and Affordable Care Act.

(d) Terms relating to income and families

For purposes of this section—

(1) Family size

The family size involved with respect to any taxpayer shall be equal to the number of individuals for whom the taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year.

(2) Household income

(A) Household income

The term "household income" means, with respect to any taxpayer, an amount equal to the sum of—

(i) the modified adjusted gross income of the taxpayer, plus

(ii) the aggregate modified adjusted gross incomes of all other individuals who—

(I) were taken into account in determining the taxpayer's family size under paragraph (1), and

(II) were required to file a return of tax imposed by section 1 for the taxable year.

(B) Modified adjusted gross income

The term "modified adjusted gross income" means adjusted gross income increased by—

(i) any amount excluded from gross income under section 911, and

(ii) any amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax.

(3) Poverty line

(A) In general

The term "poverty line" has the meaning given that term in section 2110(c)(5) of the Social Security Act (42 U.S.C. 1397jj(c)(5)).

(B) Poverty line used

In the case of any qualified health plan offered through an Exchange for coverage during a taxable year beginning in a calendar year, the poverty line used shall be the most recently published poverty line as of the 1st day of the regular enrollment period for coverage during such calendar year.

(e) Rules for individuals not lawfully present

(1) In general

If 1 or more individuals for whom a taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year (including the taxpayer or his spouse) are individuals who are not lawfully present—

(A) the aggregate amount of premiums otherwise taken into account under clauses (i) and (ii) of subsection (b)(2)(A) shall be reduced by the portion (if any) of such premiums which is attributable to such individuals, and

(B) for purposes of applying this section, the determination as to what percentage a taxpayer's household income bears to the poverty level for a family of the size involved shall be made under one of the following methods:

(i) A method under which—

(I) the taxpayer's family size is determined by not taking such individuals into account, and

(II) the taxpayer's household income is equal to the product of the taxpayer's household income (determined without regard to this subsection) and a fraction—

(aa) the numerator of which is the poverty line for the taxpayer's family size determined after application of subclause (I), and

(bb) the denominator of which is the poverty line for the taxpayer's family size determined without regard to subclause (I).

(ii) A comparable method reaching the same result as the method under clause (i).

(2) Lawfully present

For purposes of this section, an individual shall be treated as lawfully present only if the individual is, and is reasonably expected to be for the entire period of enrollment for which the credit under this section is being claimed, a citizen or national of the United States or an alien lawfully present in the United States.

(3) Secretarial authority

The Secretary of Health and Human Services, in consultation with the Secretary, shall prescribe rules setting forth the methods by which calculations of family size and household income are made for purposes of this subsection. Such rules shall be designed to ensure that the least burden is placed on individuals enrolling in qualified health plans through an Exchange and taxpayers eligible for the credit allowable under this section.

(f) Reconciliation of credit and advance credit

(1) In general

The amount of the credit allowed under this section for any taxable year shall be reduced (but not below zero) by the amount of any advance payment of such credit under section 1412 of the Patient Protection and Affordable Care Act.

(2) Excess advance payments

(A) In general

If the advance payments to a taxpayer under section 1412 of the Patient Protection and Affordable Care Act for a taxable year exceed the credit allowed by this section (determined without regard to paragraph (1)), the tax imposed by this chapter for the taxable year shall be

increased by the amount of such excess.

(B) Limitation on increase

(i) In general

In the case of a taxpayer whose household income is less than 500 percent of the poverty line for the size of the family involved for the taxable year, the amount of the increase under subparagraph (A) shall in no event exceed the applicable dollar amount determined in accordance with the following table (one-half of such amount in the case of a taxpayer whose tax is determined under section 1(c) for the taxable year):

If the household income (expressed as a percent of poverty line) is:	The applicable dollar amount is:
Less than 200%	$600
At least 200% but less than 250%	$1,000
At least 250% but less than 300%	$1,500
At least 300% but less than 350%	$2,000
At least 350% but less than 400%	$2,500
At least 400% but less than 450%	$3,000
At least 450% but less than 500%	$3,500.

(ii) Indexing of amount

In the case of any calendar year beginning after 2014, each of the dollar amounts in the table contained under clause (i) shall be increased by an amount equal to—

(I) such dollar amount, multiplied by

(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year, determined by substituting "calendar year 2013" for "calendar year 1992" in subparagraph (B) thereof.

If the amount of any increase under clause (i) is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

(3) Information requirement

Each Exchange (or any person carrying out 1 or more responsibilities of an Exchange under section 1311(f)(3) or 1321(c) of the Patient Protection and Affordable Care Act) shall provide the following information to the Secretary and to the taxpayer with respect to any health plan provided through the Exchange:

(A) The level of coverage described in section 1302(d) of the Patient Protection and Affordable Care Act and the period such coverage was in effect.

(B) The total premium for the coverage without regard to the credit under this section or cost-sharing reductions under section 1402 of such Act.

(C) The aggregate amount of any advance payment of such credit or reductions under section 1412 of such Act.

(D) The name, address, and TIN of the primary insured and the name and TIN of each other individual obtaining coverage under the policy.

(E) Any information provided to the Exchange, including any change of circumstances, necessary to determine eligibility for, and the amount of, such credit.

(F) Information necessary to determine whether a taxpayer has received excess advance payments.

(g) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section, including regulations which provide for—

(1) the coordination of the credit allowed under this section with the program for advance payment of the credit under section 1412 of the Patient Protection and Affordable Care Act, and

(2) the application of subsection (f) where the filing status of the taxpayer for a taxable year is different from such status used for determining the advance payment of the credit.

(Added and amended Pub. L. 111–148, title I, §1401(a), title X, §§10105(a)–(c), 10108(h)(1), Mar. 23, 2010, 124 Stat. 213, 906, 914; Pub. L. 111–152, title I, §§1001(a), 1004(a)(1)(A), (2)(A), (c), Mar. 30, 2010, 124 Stat. 1030, 1034, 1035; Pub. L. 111–309, title II, §208(a), (b), Dec. 15, 2010, 124 Stat. 3291, 3292.)

References in Text

Sections 1251, 1301, 1302, 1311, 1321, 1402, and 1412 of the Patient Protection and Affordable Care Act, referred to in text, are classified to sections 18011, 18021, 18022, 18031, 18041, 18071, and 18082, respectively, of Title 42, The Public Health and Welfare.

Sections 2701 and 2705(d) of the Public Health Service Act, referred to in subsec. (b)(3)(C), are classified to sections 300gg and 300gg–4(d), respectively, of Title 42, The Public Health and Welfare.

The Social Security Act, referred to in subsec. (c)(1)(B)(ii), is act Aug. 14, 1935, ch. 531, 49 Stat. 620. Title XIX of the Act is classified generally to subchapter XIX (§1396 et seq.) of chapter 7 of Title 42, The Public Health and Welfare. For complete classification of this Act to the Code, see section 1305 of Title 42 and Tables.

Section 10108 of the Patient Protection and Affordable Care Act, referred to in subsec. (c)(2)(D), is section 10108 of Pub. L. 111–148, which enacted section 139D of this title and section 18101 of Title 42, The Public Health and Welfare, amended this section and sections 162, 4980H, 6056, and 6724 of this title and section 218b of Title 29, Labor, and enacted provisions set out as notes under this section and sections 139D, 162, 4980H, and 6056 of this title. For complete classification of section 10108 to the Code, see Tables.

Amendments

2010—Subsec. (b)(3)(A)(i). Pub. L. 111–152, §1001(a)(1)(A), substituted "for any taxable year shall be the percentage such that the applicable percentage for any taxpayer whose household income is within an income tier specified in the following table shall increase, on a sliding scale in a linear manner, from the initial premium percentage to the final premium percentage specified in such table for such income tier:" for "with respect to any taxpayer for any taxable year is equal to 2.8 percent, increased by the number of percentage points (not greater than 7) which bears the same ratio to 7 percentage points as—" in introductory provisions, inserted table, and struck out subcls. (I) and (II) which read as follows:

"(I) the taxpayer's household income for the taxable year in excess of 100 percent of the poverty line for a family of the size involved, bears to

"(II) an amount equal to 200 percent of the poverty line for a family of the size involved."

Subsec. (b)(3)(A)(ii). Pub. L. 111–152, §1001(a)(1)(B), added cl. (ii) and struck out former cl. (ii). Text read as follows: "If a taxpayer's household income for the taxable year equals or exceeds 100 percent, but not more than 133 percent, of the poverty line for a family of the size involved, the taxpayer's applicable percentage shall be 2 percent."

Pub. L. 111–148, §10105(a), substituted "equals or exceeds" for "is in excess of".

Subsec. (b)(3)(A)(iii). Pub. L. 111–152, §1001(a)(1)(B), struck out cl. (iii). Text read as follows: "In the case of taxable years beginning in any calendar year after 2014, the Secretary shall adjust the initial and final applicable percentages under clause (i), and the 2 percent under clause (ii), for the calendar year to reflect the excess of the rate of premium growth between the preceding calendar year and 2013 over the rate of income growth for such period."

Subsec. (c)(1)(A). Pub. L. 111–148, §10105(b), inserted "equals or" before "exceeds".

Subsec. (c)(2)(C)(i)(II). Pub. L. 111–152, §1001(a)(2)(A), substituted "9.5 percent" for "9.8 percent".

Subsec. (c)(2)(C)(iv). Pub. L. 111–152, §1001(a)(2), substituted "9.5 percent" for "9.8 percent" and "(b)(3)(A)(ii)" for "(b)(3)(A)(iii)".

Pub. L. 111–148, §10105(c), substituted "subsection (b)(3)(A)(iii)" for "subsection (b)(3)(A)(ii)".

Subsec. (c)(2)(D). Pub. L. 111–148, §10108(h)(1), added subpar. (D).

Subsec. (d)(2)(A)(i), (ii). Pub. L. 111–152, §1004(a)(1)(A), substituted "modified adjusted gross" for "modified gross".

Subsec. (d)(2)(B). Pub. L. 111–152, §1004(a)(2)(A), amended subpar. (B) generally. Prior to amendment, text read as follows: "The term 'modified gross income' means gross income—

"(i) decreased by the amount of any deduction allowable under paragraph (1), (3), (4), or (10) of section 62(a),

"(ii) increased by the amount of interest received or accrued during the taxable year which is exempt from tax imposed by this chapter, and

"(iii) determined without regard to sections 911, 931, and 933."

Subsec. (f)(2)(B). Pub. L. 111–309, §208(a), amended generally subpar. heading and cl. (i). Prior to amendment, text of cl. (i) read as follows: "In the case of an applicable taxpayer whose household income is less than 400 percent of the poverty line for the size of the family involved for the taxable year, the amount of the increase under subparagraph (A) shall in no event exceed $400 ($250 in the case of a taxpayer whose tax is determined under section 1(c) for the taxable year)."

Subsec. (f)(2)(B)(ii). Pub. L. 111–309, §208(b), inserted "in the table contained" after "each of the dollar amounts" in introductory provisions.

Subsec. (f)(3). Pub. L. 111–152, §1004(c), added par. (3).

Effective Date of 2010 Amendment

Pub. L. 111–309, title II, §208(c), Dec. 15, 2010, 124 Stat. 3292, provided that: "The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2013."

Pub. L. 111–148, title X, §10108(h)(2), Mar. 23, 2010, 124 Stat. 914, provided that: "The amendment made by this subsection [amending this section] shall apply to taxable years beginning after December 31, 2013."

Effective Date

Pub. L. 111–148, title I, §1401(e), Mar. 23, 2010, 124 Stat. 220, provided that: "The amendments made by this section [enacting this section and amending sections 280C and 6211 of this title and section 1324 of Title 31, Money and Finance] shall apply to taxable years ending after December 31, 2013."

[1] *So in original. Probably should be preceded by "section".*

Title 26: Internal Revenue
PART 1—INCOME TAXES

§1.36B-1 Premium tax credit definitions.

(a) *In general.* Section 36B allows a refundable premium tax credit for taxable years ending after December 31, 2013. The definitions in this section apply to this section and §§1.36B-2 through 1.36B-5.

(b) *Affordable Care Act.* The term *Affordable Care Act* refers to the Patient Protection and Affordable Care Act, Public Law 111-148 (124 Stat. 119 (2010)), and the Health Care and Education Reconciliation Act of 2010, Public Law 111-152 (124 Stat. 1029 (2010)), as amended by the Medicare and Medicaid Extenders Act of 2010, Public Law 111-309 (124 Stat. 3285 (2010)), the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, Public Law 112-9 (125 Stat. 36 (2011)), the Department of Defense and Full-Year Continuing Appropriations Act, 2011, Public Law 112-10 (125 Stat. 38 (2011)), and the 3% Withholding Repeal and Job Creation Act, Public Law 112-56 (125 Stat. 711 (2011)).

(c) *Qualified health plan.* The term *qualified health plan* has the same meaning as in section 1301(a) of the Affordable Care Act (42 U.S.C. 18021(a)) but does not include a catastrophic plan described in section 1302(e) of the Affordable Care Act (42 U.S.C. 18022(e)).

(d) *Family and family size.* A taxpayer's family means the individuals for whom a taxpayer properly claims a deduction for a personal exemption under section 151 for the taxable year. Family size means the number of individuals in the family. Family and family size may include individuals who are not subject to or are exempt from the penalty under section 5000A for failing to maintain minimum essential coverage.

(e) *Household income*—(1) *In general.* Household income means the sum of—

(i) A taxpayer's modified adjusted gross income; plus

(ii) The aggregate modified adjusted gross income of all other individuals who—

(A) Are included in the taxpayer's family under paragraph (d) of this section; and

(B) Are required to file a return of tax imposed by section 1 for the taxable year (determined without regard to the exception under section (1)(g)(7) to the requirement to file a return).

(2) *Modified adjusted gross income.* Modified adjusted gross income means adjusted gross income (within the meaning of section 62) increased by—

(i) Amounts excluded from gross income under section 911;

(ii) Tax-exempt interest the taxpayer receives or accrues during the taxable year; and

(iii) Social security benefits (within the meaning of section 86(d)) not included in gross income under section 86.

(f) *Dependent.* Dependent has the same meaning as in section 152.

(g) *Lawfully present.* Lawfully present has the same meaning as in 45 CFR 155.20.

(h) *Federal poverty line.* The Federal poverty line means the most recently published poverty guidelines (updated periodically in the FEDERAL REGISTER by the Secretary of Health and Human Services under the authority of 42 U.S.C. 9902(2)) as of the first day of the regular enrollment period for coverage by a qualified health plan offered through an Exchange for a calendar year. Thus, the Federal poverty line for computing the premium tax credit for a taxable year is the Federal poverty line in effect on the first day of the initial or annual open enrollment period preceding that taxable year. See 45 CFR 155.410. If a taxpayer's primary residence changes during a taxable year from one state to a state with different Federal poverty guidelines or married taxpayers reside in separate states with different Federal poverty guidelines (for example, Alaska or Hawaii and another state), the Federal poverty line that applies for purposes of section 36B and the associated regulations is the higher Federal poverty guideline (resulting in a lower percentage of the Federal poverty line for the taxpayers' household income and family size).

(i) [Reserved]

(j) *Advance credit payment.* Advance credit payment means an advance payment of the premium tax credit as provided in section 1412 of the Affordable Care Act (42 U.S.C. 18082).

(k) *Exchange.* Exchange has the same meaning as in 45 CFR 155.20.

(l) *Self-only coverage.* Self-only coverage means health insurance that covers one individual

(l) *Self-only coverage.* Self-only coverage means health insurance that covers one individual.

(m) *Family coverage.* Family coverage means health insurance that covers more than one individual.

(n) *Rating area.* [Reserved]

(o) *Effective/applicability date.* This section and §§1.36B-2 through 1.36B-5 apply for taxable years ending after December 31, 2013.

[T.D. 9590, 77 FR 30385, May 23, 2012]

Code of Federal Regulations

Title 42 - Public Health

Volume: 4
Date: 2012-10-01
Original Date: 2012-10-01
Title: Section 435.603 - Application of modified adjusted gross income (MAGI).
Context: Title 42 - Public Health. CHAPTER IV - CENTERS FOR MEDICARE & MEDICAID SERVICES, DEPARTMENT OF HEALTH AND HUMAN SERVICES (CONTINUED). SUBCHAPTER C - MEDICAL ASSISTANCE PROGRAMS. PART 435 - ELIGIBILITY IN THE STATES, DISTRICT OF COLUMBIA, THE NORTHERN MARIANA ISLANDS, AND AMERICAN SAMOA. Subpart G - General Financial Eligibility Requirements and Options.

§ 435.603 Application of modified adjusted gross income (MAGI).

(a) *Basis, scope, and implementation.* (1) This section implements section 1902(e)(14) of the Act.

(2) Effective January 1, 2014, the agency must apply the financial methodologies set forth in this section in determining the financial eligibility of all individuals for Medicaid, except for individuals identified in paragraph (j) of this section and as provided in paragraph (a)(3) of this section.

(3) In the case of determining ongoing eligibility for beneficiaries determined eligible for Medicaid coverage to begin on or before December 31, 2013, application of the financial methodologies set forth in this section will not be applied until March 31, 2014 or the next regularly-scheduled renewal of eligibility for such individual under § 435.916 of this part, whichever is later.

(b) *Definitions.* For purposes of this section—

Code means the Internal Revenue Code.

Family size means the number of persons counted as members of an individual's household. In the case of determining the family size of a pregnant woman, the pregnant woman is counted as herself plus the number of children she is expected to deliver. In the case of determining the family size of other individuals who have a pregnant woman in their household, the pregnant woman is counted, at State option, as either 1 or 2 person(s) or as herself plus the number of children she is expected to deliver.

Tax dependent has the meaning provided in § 435.4 of this part.

(c) *Basic rule.* Except as specified in paragraph (i) and (j) of this section, the agency must determine financial eligibility for Medicaid based on "household income" as defined in paragraph (d) of this section.

(d) *Household income*—(1) *General rule.* Except as provided in paragraphs (d)(2) and (d)(3) of this section, household income is the sum of the MAGI-based income, as defined in paragraph (e) of this section, of every individual included in the individual's household, minus an amount equivalent to 5 percentage points of the Federal poverty level for the applicable family size.

(2) *Income of children and tax dependents.* (i) The MAGI-based income of an individual who is included in the household of his or her natural, adopted or step parent and is not expected to be required to file a tax return under section 6012(a)(1) of the Code for the taxable year in which eligibility for Medicaid is being determined, is not included in household income whether or not the individual files a tax return.

(ii) The MAGI-based income of a tax dependent described in paragraph (f)(2)(i) of this section who is not expected to be required to file a tax return under section 6012(a)(1) of the Code for the taxable year in which eligibility for Medicaid is being determined is not included in the household income of the taxpayer whether or not such tax dependent files a tax return.

(3) In the case of individuals described in paragraph (f)(2)(i) of this section, household income may, at State option, also include actually available cash support, exceeding nominal amounts, provided by the person claiming such individual as a tax dependent.

(e) *MAGI-based income.* For the purposes of this section, MAGI-based income means income calculated using the same financial methodologies used to determine modified adjusted gross income as defined in section 36B(d)(2)(B) of the Code, with the following exceptions—

(1) An amount received as a lump sum is counted as income only in the month received.

(2) Scholarships, awards, or fellowship grants used for education purposes and not for living expenses are excluded from income.

(3) *American Indian/Alaska Native exceptions.* The following are excluded from income:

(i) Distributions from Alaska Native Corporations and Settlement Trusts;

(ii) Distributions from any property held in trust, subject to Federal restrictions, located within the most recent boundaries of a prior Federal reservation, or otherwise under the supervision of the Secretary of the Interior;

(iii) Distributions and payments from rents, leases, rights of way, royalties, usage rights, or natural resource extraction and harvest from—

(A) Rights of ownership or possession in any lands described in paragraph (e)(3)(ii) of this section; or

(B) Federally protected rights regarding off-reservation hunting, fishing, gathering, or usage of natural resources;

(iv) Distributions resulting from real property ownership interests related to natural resources and improvements—

(A) Located on or near a reservation or within the most recent boundaries of a prior Federal reservation; or

(B) Resulting from the exercise of federally-protected rights relating to such real property ownership interests;

(v) Payments resulting from ownership interests in or usage rights to items that have unique religious, spiritual, traditional, or cultural significance or rights that support subsistence or a traditional lifestyle according to applicable Tribal Law or custom;

(vi) Student financial assistance provided under the Bureau of Indian Affairs education programs.

(f) *Household*—(1) *Basic rule for taxpayers not claimed as a tax dependent.* In the case of an individual who expects to file a tax return for the taxable year in which an initial determination or renewal of eligibility is being made, and who does not expect to be claimed as a tax dependent by another taxpayer, the household consists of the taxpayer and, subject to paragraph (f)(5) of this section, all persons whom such individual expects to claim as a tax dependent.

(2) *Basic rule for individuals claimed as a tax dependent.* In the case of an individual who expects to be claimed as a tax dependent by another taxpayer for the taxable year in which an initial determination or renewal of eligibility is being made, the household is the household of the taxpayer claiming such individual as a tax dependent, except that the household must be determined in accordance with paragraph (f)(3) of this section in the case of—

(i) Individuals other than a spouse or a biological, adopted, or step child who expect to be claimed as a tax dependent by another taxpayer;

(ii) Individuals under the age specified by the State under paragraph (f)(3)(iv) of this section who expect to be claimed by one parent as a tax dependent and are living with both parents but whose parents do not expect to file a joint tax return; and

(iii) Individuals under the age specified by the State under paragraph (f)(3)(iv) of this section who expect to be claimed as a tax dependent by a non-custodial parent. For purposes of this section—

(A) A court order or binding separation, divorce, or custody agreement establishing physical custody controls; or

(B) If there is no such order or agreement or in the event of a shared custody agreement, the custodial parent is the parent with whom the child spends most nights.

(3) *Rules for individuals who neither file a tax return nor are claimed as a tax dependent.* In the case of

individuals who do not expect to file a Federal tax return and do not expect to be claimed as a tax dependent for the taxable year in which an initial determination or renewal of eligibility is being made, or who are described in paragraph (f)(2)(i), (f)(2)(ii), or (f)(2)(iii) of this section, the household consists of the individual and, if living with the individual—

(i) The individual's spouse;

(ii) The individual's natural, adopted and step children under the age specified in paragraph (f)(3)(iv) of this section; and

(iii) In the case of individuals under the age specified in paragraph (f)(3)(iv) of this section, the individual's natural, adopted and step parents and natural, adoptive and step siblings under the age specified in paragraph (f)(3)(iv) of this section.

(iv) The age specified in this paragraph is either of the following, as elected by the agency in the State plan —

(A) Age 19; or

(B) Age 19 or, in the case of full-time students, age 21.

(4) *Married couples.* In the case of a married couple living together, each spouse will be included in the household of the other spouse, regardless of whether they expect to file a joint tax return under section 6013 of the Code or whether one spouse expects to be claimed as a tax dependent by the other spouse.

(5) For purposes of paragraph (f)(1) of this section, if, consistent with the procedures adopted by the State in accordance with § 435.956(f) of this part, a taxpayer cannot reasonably establish that another individual is a tax dependent of the taxpayer for the tax year in which Medicaid is sought, the inclusion of such individual in the household of the taxpayer is determined in accordance with paragraph (f)(3) of this section.

(g) *No resource test or income disregards.* In the case of individuals whose financial eligibility for Medicaid is determined in accordance with this section, the agency must not—

(1) Apply any assets or resources test; or

(2) Apply any income or expense disregards under sections 1902(r)(2) or 1931(b)(2)(C), or otherwise under title XIX of the Act, except as provided in paragraph (d)(1) of this section.

(h) *Budget period*—(1) *Applicants and new enrollees.* Financial eligibility for Medicaid for applicants, and other individuals not receiving Medicaid benefits at the point at which eligibility for Medicaid is being determined, must be based on current monthly household income and family size.

(2) *Current beneficiaries.* For individuals who have been determined financially-eligible for Medicaid using the MAGI-based methods set forth in this section, a State may elect in its State plan to base financial eligibility either on current monthly household income and family size or income based on projected annual household income and family size for the remainder of the current calendar year.

(3) In determining current monthly or projected annual household income and family size under paragraphs (h)(1) or (h)(2) of this section, the agency may adopt a reasonable method to include a prorated portion of reasonably predictable future income, to account for a reasonably predictable increase or decrease in future income, or both, as evidenced by a signed contract for employment, a clear history of predictable fluctuations in income, or other clear indicia of such future changes in income. Such future increase or decrease in income or family size must be verified in the same manner as other income and eligibility factors, in accordance with the income and eligibility verification requirements at § 435.940 through § 435.965, including by self-attestation if reasonably compatible with other electronic data obtained by the agency in accordance with such sections.

(i) If the household income of an individual determined in accordance with this section results in financial ineligibility for Medicaid and the household income of such individual determined in accordance with 26 CFR 1.36B-1(e) is below 100 percent FPL, Medicaid financial eligibility will be determined in accordance with 26 CFR 1.36B-1(e).

(j) *Eligibility Groups for which MAGI-based methods do not apply.* The financial methodologies described in this section are not applied in determining the Medicaid eligibility of individuals described in this paragraph. The agency must use the financial methods described in § 435.601 and § 435.602 of this subpart.

(1) Individuals whose eligibility for Medicaid does not require a determination of income by the agency, including, but not limited to, individuals receiving Supplemental Security Income (SSI) eligible for Medicaid under § 435.120 of this part, individuals deemed to be receiving SSI and eligible for Medicaid under § 435.135, § 435.137 or § 435.138 of this part and individuals for whom the State relies on a finding of income made by an Express Lane agency, in accordance with section 1902(e)(13) of the Act.

(2) Individuals who are age 65 or older when age is a condition of eligibility.

(3) Individuals whose eligibility is being determined on the basis of being blind or disabled, or on the basis of being treated as being blind or disabled, including, but not limited to, individuals eligible under § 435.121, § 435.232 or § 435.234 of this part or under section 1902(e)(3) of the Act, but only for the purpose of determining eligibility on such basis.

(4) Individuals who request coverage for long-term services and supports for the purpose of being evaluated for an eligibility group under which long-term services and supports are covered. "Long-term services and supports" include nursing facility services, a level of care in any institution equivalent to nursing facility services; home and community-based services furnished under a waiver or State plan under sections 1915 or 1115 of the Act; home health services as described in sections 1905(a)(7) of the Act and personal care services described in sections 1905(a)(24) of the Act.

(5) Individuals who are being evaluated for eligibility for Medicare cost sharing assistance under section 1902(a)(10)(E) of the Act, but only for purposes of determining eligibility for such assistance.

(6) Individuals who are being evaluated for coverage as medically needy under subparts D and I of this part, but only for the purpose of determining eligibility on such basis.

[77 FR 17206, Mar. 23, 2012]

Effective Date Note: At 77 FR 17206, Mar. 23, 2012, § 435.603 was added, effective Jan. 1, 2014.

2014

Instructions for Form 8962

Premium Tax Credit (PTC)

Department of the Treasury
Internal Revenue Service

CAUTION *Complete Form 8962 **only** for health insurance coverage in a qualified health plan (described later) purchased through a Health Insurance Marketplace (also known as an Exchange). This includes a qualified health plan purchased on healthcare.gov or through a State Marketplace.*

Future Developments

For the latest information about developments related to Form 8962 and its instructions, such as legislation enacted after they were published, go to *www.irs.gov/form8962*.

Reminder for 2015

Report changes in circumstances when you re-enroll in coverage and during the year. If advance payments of the premium tax credit (APTC) were made in 2014 or are made in 2015 for an individual in your tax family (described later) and you have had certain changes in circumstances (see the examples below), it is important that you report them to the Marketplace where you enroll. Reporting changes in circumstances promptly will allow the Marketplace to adjust your APTC to more accurately reflect the premium tax credit (PTC) you are estimated to be able to take on your tax return. Adjusting your APTC when you re-enroll in coverage and during the year can help you avoid owing tax when you file your tax return. Changes that you should report to the Marketplace include the following.

- Changes in household income.
- Moving to a different address.
- Gaining or losing eligibility for other health care coverage.
- Gaining, losing, or other changes to employment.
- Birth or adoption.
- Marriage or divorce.
- Other changes affecting the composition of your tax family.

General Instructions

Purpose of Form

Use Form 8962 to figure the amount of your PTC and reconcile it with any APTC paid.

What is the Premium Tax Credit (PTC)?

Premium tax credit (PTC). The PTC is a tax credit for certain people who enroll, or whose family member enrolls, in a qualified health plan offered through a Marketplace. The credit provides financial assistance to pay the premiums by reducing the amount of tax you owe, giving you a refund, or increasing your refund amount. You must file Form 8962 to compute and take the PTC on your tax return.

Advance payment of the premium tax credit (APTC). APTC is a payment made for coverage during the year to your insurance provider that pays for part or all of the premiums for the coverage of you or an individual in your tax family. Your APTC eligibility is based on the Marketplace's estimate of the PTC you will be able to take on your tax return. If APTC was paid for you or an individual in your tax family, you must file Form 8962 to reconcile (compare) this APTC with your PTC. If the APTC is more than your PTC, you have excess APTC and you must repay the excess, subject to certain limitations. If your PTC is more than the APTC, you can reduce your tax payment or increase your refund by the difference.

Note. The Marketplace determined your eligibility for 2014 APTC using projections of your income and your number of personal exemptions when you enrolled in a qualified health plan. If this information changed during 2014 and you did not promptly report it to the Marketplace, the amount of APTC paid may be substantially different from the amount of PTC you can take on your tax return. See *Report changes in circumstances when you re-enroll in coverage and during the year*, earlier, for changes that can affect the amount of your PTC.

Additional Information

You will need Form 1095-A, Health Insurance Marketplace Statement, to complete Form 8962. The Marketplace is required to provide or send Form 1095-A to the tax filer(s) identified in the enrollment application by January 31, 2015. If you are the tax filer expecting to receive Form 1095-A for a qualified health plan and you do not receive it by early February, contact the Marketplace.

Under certain circumstances, for example in the case of a divorce during the year, the Marketplace will provide Form 1095-A to one taxpayer, but another taxpayer will also need the information from that form to complete Form 8962. The recipient of Form 1095-A should provide a copy to other taxpayers as needed.

For additional information on the PTC, see Publication 974, Premium Tax Credit (PTC). You can also visit *www.irs.gov* and enter "premium tax credit" in the search box.

Self-employed health insurance deduction. If you are claiming the self-employed health insurance deduction for health insurance premiums, see Pub. 974.

Who Must File

You must file Form 8962 with your income tax return (Form 1040, Form 1040A, or Form 1040NR) if any of the following apply to you.

- You are taking the PTC.
- APTC was paid for you or another individual in your tax family.
- APTC was paid for an individual (including you) for whom you told the Marketplace you would claim a personal exemption and neither you nor anyone else claims a personal exemption for that individual. See *Individual you enrolled for whom no taxpayer will claim a personal exemption* under *Lines 12 through 23—Monthly Calculation*, later.

If any of the circumstances above apply to you, you must file an income tax return and attach Form 8962 even if you are not otherwise required to file. You must file Form 1040, Form 1040A, or Form 1040NR.

If you are claimed as a dependent, the person who claims you will file Form 8962 to take the PTC and, if necessary, repay excess APTC for your coverage. You do not need to file Form 8962.

If you are filing Form 8962, you cannot file Form 1040EZ, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.

If someone else enrolled an individual in your tax family in coverage, and APTC was paid for that individual's coverage, you must file Form 8962 to reconcile the APTC. You need to obtain a copy of the Form 1095-A from the person who enrolled the individual.

Who Can Take the PTC

You can take the PTC for 2014 if you meet all of the conditions under (1) and (2) below.

1. For at least one month of the year, all of the following were true.

a. An individual in your tax family was enrolled in a qualified health plan offered through the Marketplace.

b. The individual was not eligible for minimum essential coverage, other than coverage in the individual market (see *Minimum essential coverage*, later).

c. The portion of the enrollment premiums for the month for which you are responsible was paid by the due date of your tax return (not including extensions).

2. You are an applicable taxpayer. To be an applicable taxpayer, you must meet all of the following requirements.

a. For 2014, your household income is at least 100% but no more than 400% of the Federal poverty line for your family size (see *Household income below 100% of the Federal poverty line*, later, for certain exceptions).

b. No one can claim you as a dependent on a tax return for 2014.

c. If you were married at the end of 2014, you must generally file a joint return. However, filing a separate return from your spouse will not disqualify you from being an applicable taxpayer if you meet certain requirements described under *Married taxpayers*, later.

You are not entitled to the PTC for your own health coverage for any period during which you are not lawfully present in the United States.

For additional requirements and more details, see *Applicable taxpayer*, later.

Terms You May Need to Know

Tax family. For purposes of the PTC, your tax family consists of the individuals for whom you claim a personal exemption on your tax return (generally you, your spouse with whom you are filing a joint return, and your dependents). Your personal exemptions are reported on your Form 1040 or Form 1040A, line 6d, or Form 1040NR, line 7d. Your family size equals the number of individuals in your tax family. If no one, including you, claims a personal exemption for you, and you indicated to the Marketplace when you enrolled that you would claim your own personal exemption, see Pub. 974 for instructions on completing Form 8962.

Household income. For purposes of the PTC, household income is the modified adjusted gross income (modified AGI) of you and your spouse (if filing a joint return) (see *Line 2a*, later) plus the modified AGI of each individual in your tax family whom you claim as a dependent and who is required to file a tax return because his or her income meets the income tax return filing threshold (see *Line 2b*, later). Household income does not include the modified AGI of those individuals whom you claim as dependents and who are filing a 2014 return only to claim a refund of withheld income tax or estimated tax. If your household income is less than zero, enter -0- on line 3.

Modified AGI. For purposes of the PTC, modified AGI is the AGI on your tax return plus certain income that is not subject to tax (foreign earned income, tax-exempt interest, and the portion of social security benefits that is not taxable). Use Worksheet 1-1 and Worksheet 1-2, later, to determine your modified AGI.

Taxpayer's tax return including income of a dependent child. A taxpayer who includes the gross income of a dependent child on the taxpayer's tax return must include in modified AGI the child's tax-exempt interest and the portion of social security benefits that is not taxable.

Monthly credit amount. The monthly credit amount is the amount of assistance in paying premiums for a month. Your PTC for the year is the sum of all of your monthly credit amounts. Your credit amount for each month is the lesser of:

- The enrollment premiums (described next) for the month for one or more qualified health plans in which you or any individual in your tax family enrolled; or
- The amount of the monthly premium for your applicable second lowest cost silver plan (SLCSP) (described below) less your monthly contribution amount (described below).

Enrollment premiums. The enrollment premiums are the total amount of the premiums for the month for one or more qualified health plans in which any individual in your tax family enrolled. Form 1095-A, Part III, column A, reports the enrollment premiums.

You are not allowed a monthly credit amount for the month if any part of the enrollment premiums for which you are responsible that month has not been paid by the due date of your tax return (not including extensions). Premiums another person pays on your behalf are treated as paid by you.

Premium for the applicable SLCSP. The premium for the applicable SLCSP is the second lowest cost silver plan premium offered through the Marketplace where you reside that applies to your coverage family (described below). The premium for the applicable SLCSP is not the same as your enrollment premium, unless you enroll in the applicable SLCSP. Form 1095-A, Part III, column B, generally reports the premium for the applicable SLCSP.

Monthly contribution amount. Your monthly contribution amount is the amount you would be required to pay as your share of premiums each month if you enrolled in the applicable SLCSP. Your monthly contribution amount is not based on the amount of premiums you paid out of pocket. You will compute your monthly contribution amount in Part 1 of Form 8962.

Termination for nonpayment of premiums. If you did not pay your premiums for three months and your policy was terminated, you are not allowed monthly credit amounts for those months. However, you continued to have coverage for at least the first month of nonpayment. If APTC was paid to your issuer you must repay it. See *Lines 12 through 23—Monthly Calculation*, later.

Coverage family. Your coverage family includes all individuals in your tax family who are enrolled in a qualified health plan and are not eligible for minimum essential coverage (other than coverage in the individual market). The individuals included in your coverage family may change from month to month. If individuals in your tax family are not enrolled in a qualified health plan, or are enrolled in a qualified health plan but are eligible for minimum essential coverage (other than coverage in the individual market), they are not part of your coverage family.

Your applicable SLCSP is the SLCSP that applies to your coverage family. As a result, your PTC is only available to help you pay for the coverage of the individuals included in your coverage family.

Child born or adopted or placed with you for adoption or foster care during the month. If you enroll a newborn child (or a child newly adopted or placed with you for adoption or foster

care) in a qualified health plan, and the child's coverage is effective as of the date of birth, adoption, or placement, the child is treated as enrolled as of the first day of the month the child was born, adopted, or placed with you for adoption or foster care. The child is included in your coverage family for the month of birth, adoption, or placement for adoption or in foster care.

Qualified health plan. For purposes of the PTC, a qualified health plan is a health insurance plan or policy purchased through a Marketplace at the bronze, silver, gold, or platinum level. Plans sold as "catastrophic" coverage and plans purchased through the Small Business Health Options Program (SHOP) do not qualify a taxpayer to take the PTC. Throughout these instructions, a qualified health plan is also referred to as a policy.

Minimum essential coverage. Under the health care law, certain health coverage is called minimum essential coverage. Even if you have coverage purchased through a Marketplace, you cannot take the PTC for any individual in your tax family for any month when that individual is eligible for minimum essential coverage, other than coverage in the individual market. Types of minimum essential coverage include:

- Government-sponsored programs (including most Medicaid coverage, Medicare parts A or C, the Children's Health Insurance Program (CHIP), and Tricare).
- Employer-sponsored coverage, if the premiums are affordable and the deductibles and co-pays are no more than a certain amount, or if you enroll.
- Other health coverage the Department of Health and Human Services designates as minimum essential coverage.

Coverage purchased in the individual market outside the Marketplace is minimum essential coverage. Eligibility for this type of coverage does not prevent you from being eligible for the PTC for Marketplace coverage, but it does not qualify for the PTC.

For more details on eligibility for minimum essential coverage, including special eligibility rules, see *Minimum Essential Coverage* in Pub. 974. You can also check *www.irs.gov/uac/Individual-Shared-Responsibility-Provision* for future updates about types of coverage that are recognized as minimum essential coverage.

Example. You, your spouse, and your two children whom you claim as dependents were enrolled in a qualified health plan in 2014. Your children were eligible for coverage under CHIP. Your tax family size is four, consisting of you, your spouse, and your children. Your coverage family has only two members, you and your spouse. Your children are not part of the coverage family because they were eligible for CHIP, which is minimum essential coverage. As a result, although your children were enrolled in a qualified health plan, the PTC provides financial assistance only for the coverage of you and your spouse.

Applicable taxpayer. You must be an applicable taxpayer to take the PTC.

Generally, you are an applicable taxpayer if your household income for 2014 (described earlier) is at least 100% but not more than 400% of the Federal poverty line for your family size (provided in Tables 1-1, 1-2, and 1-3, later) and no one can claim you as a dependent for 2014. In addition, if you were married at the end of 2014, you must file a joint return to be an applicable taxpayer unless you meet one of the situations described in *Married taxpayers*, later.

For individuals with household income below 100% of the Federal poverty line, see *Household income below 100% of the Federal poverty line* under *Line 6*, later.

Individuals who are incarcerated. Individuals who are incarcerated (other than pending disposition of charges, for example awaiting trial) are not eligible to enroll in a qualified health plan through a Marketplace. However, these individuals may be applicable taxpayers and take the PTC for the coverage of individuals in their tax families who are eligible to enroll in a qualified health plan.

Individuals who are not lawfully present. Individuals who are not lawfully present in the United States are not eligible to enroll in a qualified health plan through a Marketplace. They also are not eligible for a PTC for their own coverage, and are not eligible for the repayment limitations in Table 5 for APTC paid for their own coverage. However, these individuals may be applicable taxpayers and take the PTC for the coverage of individuals in their tax families, such as their children, who are eligible to enroll in a qualified health plan. For more information about who is treated as lawfully present for this purpose, visit *healthcare.gov*. Also see Pub. 974 for more information.

Married taxpayers. If you are married, you generally must file a joint return with your spouse to take the PTC unless one of the two situations below applies to you. However, you are unmarried for all federal income tax purposes if you are divorced or legally separated according to your state law under a decree of divorce or separate maintenance. You are treated as unmarried and can file a separate return and take the PTC if *Situation 1* applies to you. If your filing status is married filing separately, you can take the PTC if *Situation 2* applies to you.

Situation 1. You are treated as unmarried for federal income tax purposes for 2014 if one of the following applies to you.

- You file a separate return from your spouse on Form 1040 or Form 1040A because you meet the requirements for *Married persons who live apart* under *Head of Household* in the instructions for Form 1040 or Form 1040A.
- You file as single on your Form 1040NR because you meet the requirements for *Married persons who live apart* under *Were You Single or Married?* in the instructions for Form 1040NR.

Situation 2. If you are a victim of domestic abuse or spousal abandonment, you can file a return as married filing separately and take the PTC if you meet all of the following.

- You are living apart from your spouse at the time you file your 2014 tax return.
- You are unable to file a joint return because you are a victim of domestic abuse (described next) or spousal abandonment (described below).
- You certify on your Form 8962 that you are a victim of domestic abuse or spousal abandonment.

Domestic abuse. Domestic abuse includes physical, psychological, sexual, or emotional abuse, including efforts to control, isolate, humiliate, and intimidate, or to undermine the victim's ability to reason independently. All the facts and circumstances are considered in determining whether an individual is abused, including the effects of alcohol or drug abuse by the victim's spouse. Depending on the facts and circumstances, abuse of the victim's child or other family member living in the household may constitute abuse of the victim.

Spousal abandonment. A taxpayer is a victim of spousal abandonment for a tax year if, taking into account all facts and circumstances, the taxpayer is unable to locate his or her spouse after reasonable diligence.

To certify that you are eligible for an exception to the requirement to file a joint return under Situation 2, check the **"Relief"** box in the top right-hand corner of Form 8962. Do not attach documentation of the abuse or abandonment to your tax return. Keep any documentation you may have with your tax return records. For examples of what documentation to keep, see Pub. 974.

Married filing separately. If you file as married filing separately and are not a victim of domestic abuse or spousal abandonment (see *Situation 2* under *Married taxpayers* above), then you are not an applicable taxpayer and you cannot take the PTC. You must generally repay all APTC paid for a qualified

health plan that covered only individuals in your tax family, and one-half of the APTC paid for a policy that covered at least one individual in your tax family and at least one individual in your spouse's tax family. However, the amount of APTC you have to repay may be limited. See the instructions for line 28, later.

Specific Instructions

Name. Print or type your name exactly as you entered it on your tax return. If you are married and filing a joint return, enter the first name that appears on your return.

Social security number. The social security number on this form should match the social security number on your tax return. If you are married and filing a joint return, enter the first social security number that appears on your tax return.

Relief. Check this box if you are filing as married filing separately and you are a victim of domestic abuse or spousal abandonment (see *Situation 2* under *Married taxpayers*, earlier). By checking this box, you are certifying that you qualify for relief from filing a joint return with your spouse.

Married filing separately. If you do not qualify for relief from filing a joint return, you cannot take the PTC on a married filing separately return. You are not an applicable taxpayer and must repay some or all APTC. Complete lines 1 through 5 to figure your separate household income as a percentage of the Federal poverty line. Skip lines 6 through 8b and complete lines 9 and 10 (and Part 4, if applicable). When completing line 11 or lines 12 through 23, complete only column F. Then complete the rest of the form to determine how much you must repay.

Part 1—Annual and Monthly Contribution Amount

Line 1

Enter on line 1 the number of exemptions from your Form 1040 or Form 1040A, line 6d, or Form 1040NR, line 7d.

Line 2a

Enter your modified AGI on line 2a. Use the worksheet next to figure your modified AGI from your tax return.

Worksheet 1-1. Taxpayer's Modified AGI—Line 2a

1. Enter your adjusted gross income (AGI)* from Form 1040, line 38; Form 1040A, line 22; or Form 1040NR, line 37		1.
2. Enter any tax-exempt interest from Form 1040, line 8b; Form 1040A, line 8b; or Form 1040NR, line 9b	2.	
3. Enter any amounts from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18	3.	
4. Enter the excess, if any, of Form 1040, lines 20a over 20b; or Form 1040A, lines 14a over 14b	4.	
5. Add lines 2 through 4		5.
6. Add lines 1 and 5. Enter here and on Form 8962, line 2a		6.

**If you are filing Form 8814 and the amount on Form 8814, line 4, is more than $1,000, you must also include on line 1 of this worksheet the tax-exempt interest from Form 8814, line 1b; the lesser of Form 8814, line 4 or line 5; and any nontaxable social security benefits your child received.*

Note. If the amount on line 6 of Worksheet 1-1 above is less than zero, see *Line 3*, later, before you enter an amount on Form 8962, line 3.

Line 2b

Enter the modified AGI for all of your dependents on line 2b. Use the worksheet next to figure the combined modified AGI for the dependents claimed as exemptions on your return. Only include the modified AGI of those dependents who are required to file a return. Do not include the modified AGI of dependents who are filing a tax return only to claim a refund of tax withheld or estimated tax.

Worksheet 1-2. Dependents' Combined Modified AGI—Line 2b

1. Enter the AGI for your dependents from Form 1040, line 38; Form 1040A, line 22; Form 1040EZ, line 3; and Form 1040NR, line 37		1.
2. Enter any tax-exempt interest for your dependents from Form 1040, line 8b; Form 1040A, line 8b; Form 1040EZ, the amount written to the left of the line 2 entry space; and Form 1040NR, line 9b	2.	
3. Enter any amounts for your dependents from Form 2555, lines 45 and 50, and Form 2555-EZ, line 18	3.	
4. Enter for each of your dependents the excess, if any, of Form 1040, lines 20a over 20b; and Form 1040A, lines 14a over 14b	4.	
5. Add lines 2 through 4		5.
6. Add lines 1 and 5. Enter here and on Form 8962, line 2b		6.

Note. If the amount on line 6 of Worksheet 1-2 above is less than zero, see *Line 3* next before you enter an amount on Form 8962, line 3.

Line 3

Combine lines 2a and 2b even if one or both of them are negative. If the total of lines 2a and 2b is less than zero, enter -0- on line 3.

Line 4

Enter on line 4 the amount from the table that represents the Federal poverty line for the family size you entered on line 1 of Form 8962. Use the table for your state of residence in 2014. If you moved at all during 2014 and you lived in Alaska and/or Hawaii, or you are filing jointly and you and your spouse lived in different states, use the table with the higher dollar amounts for your family size.

Table 1-1. Federal Poverty Line for the 48 Contiguous States and the District of Columbia

IF your Family Size* from Form 8962, line 1, was . . .	**THEN** enter the amount below on Form 8962, line 4 . . .
1	$11,490
2	$15,510
3	$19,530
4	$23,550
5	$27,570
6	$31,590
7	$35,610
8	$39,630

**If your family size was more than 8 people, add $4,020 for each additional person. For example, if your family size is 11, you have 3 additional people. Multiply $4,020 by 3 and add the result of $12,060 to $39,630. Enter the result of $51,690 on Form 8962, line 4.*

Table 1-2. **Federal Poverty Line for Alaska**

IF your Family Size* from Form 8962, line 1, was . . .	**THEN** enter the amount below on Form 8962, line 4 . . .
1	$14,350
2	$19,380
3	$24,410
4	$29,440
5	$34,470
6	$39,500
7	$44,530
8	$49,560

**If your family size was more than 8 people, add $5,030 for each additional person. For example, if your family size is 11, you have 3 additional people. Multiply $5,030 by 3 and add the result of $15,090 to $49,560. Enter the result of $64,650 on Form 8962, line 4.*

Table 1-3. **Federal Poverty Line for Hawaii**

IF your Family Size* from Form 8962, line 1, was . . .	**THEN** enter the amount below on Form 8962, line 4 . . .
1	$13,230
2	$17,850
3	$22,470
4	$27,090
5	$31,710
6	$36,330
7	$40,950
8	$45,570

**If your family size was more than 8, add $4,620 for each additional person. For example, if your family size is 11, you have 3 additional people. Multiply $4,620 by 3 and add the result of $13,860 to $45,570. Enter the result of $59,430 on Form 8962, line 4.*

Line 5

Divide the amount on line 3 by the amount on line 4 to figure your household income as a percentage of the Federal poverty line. Is the result between 1.00 and 3.99?

☐ **Yes.** Round up or down to the nearest whole percentage. For example, for 1.854, enter the result as 185; for 3.565, enter the result as 357.

☐ **No.** See *Special rounding rules* next.

Special rounding rules. If the result is less than 1.00 or more than 3.99, round the result as follows.

- For any amount less than 1.00, round **down** to the nearest whole percentage. For example, for .996, enter the result as 99.
- For any amount between 3.99 and 4.00, round **down** to 399. For example, for 3.998, enter the result as 399.
- For any amount more than 4.00 but no more than 9.99, round **up** to the nearest whole percentage. For example, for 4.004, enter the result as 401.
- For an amount more than 9.99, enter the result as 999. For example, for 10.456, enter the result as 999.

Line 6

If the amount on line 5 is at least 100 but no more than 400, check the **"Yes"** box on line 6 and continue to line 7. If the amount on line 5 is less than 100, see *Household income below 100% of the Federal poverty line* next to determine if you qualify for the PTC. If the amount on line 5 is more than 400, you are not eligible for the PTC. Check the **"No"** box and see *Household income above 400% of the Federal poverty line* below for instructions on how to repay any APTC paid for your or your family's coverage.

Household income below 100% of the Federal poverty line. If the amount on line 5 is less than 100, you can take the PTC if you meet the requirements under *Estimated household income at least 100% of the Federal poverty line* next or *Alien lawfully present in the United States* below.

Estimated household income at least 100% of the Federal poverty line. You may qualify for the PTC if your household income is less than 100% of the Federal poverty line and you meet all of the following requirements.

- You or an individual in your tax family enrolled in a qualified health plan through a Marketplace.
- The Marketplace estimated at the time of your enrollment that your household income would be between 100% and 400% of the Federal poverty line for your family size for 2014.
- APTC is paid for the coverage for one or more months during 2014.
- You otherwise qualify as an applicable taxpayer (without taking into account the Federal poverty line percentage).

Alien lawfully present in the United States. Certain aliens with household income below 100% of the Federal poverty line are not eligible for Medicaid because of their immigration status. You may qualify for the PTC if your household income is less than 100% of the Federal poverty line if you meet all of the following requirements.

- You or an individual in your tax family enrolled in a qualified health plan through a Marketplace.
- The enrolled individual is lawfully present in the United States **and** is not eligible for Medicaid.
- You otherwise qualify as an applicable taxpayer (without taking into account the Federal poverty line percentage).

If you meet all of the requirements under either *Estimated household income at least 100% of the Federal poverty line* or *Alien lawfully present in the United States*, check the **"Yes"** box on line 6 and continue to line 7.

If your household income is less than 100% of the Federal poverty line and you did not meet the requirements under *Estimated household income at least 100% of the Federal poverty line* or *Alien lawfully present in the United States*, you are not an applicable taxpayer and you are not eligible to take the PTC. Check the **"No"** box on line 6, skip lines 7 and 8, and go to line 9. However, if no APTC was paid for any individuals in your tax family, **stop**; do not complete Form 8962.

Household income above 400% of the Federal poverty line. If the amount on line 5 is more than 400, you cannot take the PTC. You must repay all APTC paid for individuals in your tax family. Skip lines 7 and 8, and complete lines 9 and 10 (and Part 4, if applicable). When completing line 11 or lines 12 through 23, complete only column F. Then complete the rest of the form to determine how much you must repay. If no APTC was paid for any individuals in your tax family, **stop**; do not complete Form 8962.

If you qualify for the alternative calculation for year of marriage (see the instructions for line 9, later), you may be able to reduce the amount of APTC you have to repay. If you enrolled an individual for whom another taxpayer will claim a personal exemption, the other taxpayer may be responsible to repay all or part of the APTC (see the instructions for line 9, later).

Line 7

Enter on line 7 the decimal number from Table 2 next that applies to the amount you entered on line 5. This number is used to calculate your contribution amount.

Line 8a

Multiply line 3 by line 7 and enter the result on line 8a, rounded to the nearest whole dollar amount.

Table 2. **Applicable Figure**

TIP *If the amount on line 5 is less than 133, your applicable figure is .0200. If the amount on line 5 is between 300 through 400, your applicable figure is .0950.*

IF Form 8962, line 5 is . . .	**ENTER** on Form 8962, line 7 . . .	**IF** Form 8962, line 5 is . . .	**ENTER** on Form 8962, line 7 . . .	**IF** Form 8962, line 5 is . . .	**ENTER** on Form 8962, line 7 . . .	**IF** Form 8962, line 5 is . . .	**ENTER** on Form 8962, line 7 . . .
less than 133	0.0200	175	0.0515	218	0.0693	261	0.0837
133	0.0300	176	0.0520	219	0.0697	262	0.0840
134	0.0306	177	0.0524	220	0.0700	263	0.0843
135	0.0312	178	0.0529	221	0.0704	264	0.0846
136	0.0318	179	0.0533	222	0.0707	265	0.0849
137	0.0324	180	0.0538	223	0.0711	266	0.0851
138	0.0329	181	0.0543	224	0.0714	267	0.0854
139	0.0335	182	0.0547	225	0.0718	268	0.0857
140	0.0341	183	0.0552	226	0.0721	269	0.0860
141	0.0347	184	0.0556	227	0.0725	270	0.0863
142	0.0353	185	0.0561	228	0.0728	271	0.0866
143	0.0359	186	0.0566	229	0.0732	272	0.0869
144	0.0365	187	0.0570	230	0.0735	273	0.0872
145	0.0371	188	0.0575	231	0.0739	274	0.0875
146	0.0376	189	0.0579	232	0.0742	275	0.0878
147	0.0382	190	0.0584	233	0.0746	276	0.0880
148	0.0388	191	0.0589	234	0.0749	277	0.0883
149	0.0394	192	0.0593	235	0.0753	278	0.0886
150	0.0400	193	0.0598	236	0.0756	279	0.0889
151	0.0405	194	0.0602	237	0.0760	280	0.0892
152	0.0409	195	0.0607	238	0.0763	281	0.0895
153	0.0414	196	0.0612	239	0.0767	282	0.0898
154	0.0418	197	0.0616	240	0.0770	283	0.0901
155	0.0423	198	0.0621	241	0.0774	284	0.0904
156	0.0428	199	0.0625	242	0.0777	285	0.0907
157	0.0432	200	0.0630	243	0.0781	286	0.0909
158	0.0437	201	0.0634	244	0.0784	287	0.0912
159	0.0441	202	0.0637	245	0.0788	288	0.0915
160	0.0446	203	0.0641	246	0.0791	289	0.0918
161	0.0451	204	0.0644	247	0.0795	290	0.0921
162	0.0455	205	0.0648	248	0.0798	291	0.0924
163	0.0460	206	0.0651	249	0.0802	292	0.0927
164	0.0464	207	0.0655	250	0.0805	293	0.0930
165	0.0469	208	0.0658	251	0.0808	294	0.0933
166	0.0474	209	0.0662	252	0.0811	295	0.0936
167	0.0478	210	0.0665	253	0.0814	296	0.0938
168	0.0483	211	0.0669	254	0.0817	297	0.0941
169	0.0487	212	0.0672	255	0.0820	298	0.0944
170	0.0492	213	0.0676	256	0.0822	299	0.0947
171	0.0497	214	0.0679	257	0.0825	300 thru 400	0.0950
172	0.0501	215	0.0683	258	0.0828		
173	0.0506	216	0.0686	259	0.0831		
174	0.0510	217	0.0690	260	0.0834		

Part 2—Premium Tax Credit Claim and Reconciliation of Advance Payment of Premium Tax Credit

Line 9

If any of the following apply, see *Part 4* next and *Part 5* below. Otherwise, check the **"No"** box on line 9 and go to line 10.

- You got divorced during the year.
- You or an individual in your tax family were enrolled in a qualified health plan by someone not part of your tax family.
- You or an individual in your tax family enrolled someone not part of your tax family in a qualified health plan.
- You or an individual in your tax family were enrolled in a qualified health plan with another tax family and the applicable SLCSP premium for at least one tax family for at least one month is different from the premium reported on Form 1095-A, Part III, column B.
- You got married during 2014.

Part 4. If you got divorced in 2014, or if for other reasons one policy covered at least one individual in your tax family and at least one individual not in your tax family, see Table 3. Shared Policy Allocation—Line 9 below to determine whether you must complete Part 4.

Part 5. If you got married during the year and APTC was paid for an individual in your tax family, you may be eligible to complete Part 5 to elect an optional calculation that may reduce the amount of excess APTC you would have to repay under the general rules. See Table 4. Alternative Calculation for Year of Marriage Eligibility, later, to determine whether you qualify for the alternative calculation.

Note. If both Part 4 and Part 5 apply to you, complete Part 4 first.

Table 3. **Shared Policy Allocation—Line 9**

Follow Steps 1–5 below to determine whether you need to complete *Part 4—Shared Policy Allocation*, later, for each qualified health plan that covers at least one individual in your tax family and at least one individual **not** in your tax family. For each shared policy, if your answer directs you to Part 4, skip directly to Part 4—you do not need to complete the remaining steps below. If your answers in Steps 1 through 4 do not direct you to Part 4 (or if you did not answer any questions in Steps 1 through 4), continue until you have completed Step 5.

STEP 1: Complete if You Divorced or Legally Separated from Your Spouse in 2014

1. Did the policy cover at least one individual in your tax family **AND** cover at least one individual in your former spouse's tax family?

☐ **Yes.** You must allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

☐ **No.** Continue to Step 2.

STEP 2: Complete if You were Married at the End of 2014 but are Filing a Separate Return from Your Spouse*

2. Did the policy cover at least one individual in your tax family **AND** cover at least one individual in your spouse's tax family?

☐ **Yes.** You must allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

☐ **No.** Continue to Step 3.

*Also use this Step 2 if you meet the rules in *Situation 1* or *Situation 2* under *Married taxpayers*, earlier.

STEP 3: Complete if Another Taxpayer will Claim the Personal Exemption for an Individual You Enrolled in a Policy

3.a. Did the policy cover at least one individual in your tax family **AND** cover at least one individual whom you enrolled in the policy **but** who will be in another taxpayer's tax family*?

☐ **Yes.** Continue to question 3b.

☐ **No.** Go to Step 4.

b. Did you indicate to the Marketplace at enrollment in the policy that you intended to claim the personal exemption(s) for the individual(s) in 3a above whom you enrolled but for whom another taxpayer will claim a personal exemption?

☐ **Yes.** You must allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

☐ **No.** Continue to Step 4.

*If no one claims the personal exemption for an individual you enrolled in a policy **and** you indicated to the Marketplace that you would claim the individual's personal exemption, you are responsible for reconciling any APTC paid on behalf of the individual. See *Individual you enrolled for whom no taxpayer will claim a personal exemption* under *Lines 12 through 23—Monthly Calculation*, later. You do not need to complete Part 4 for this policy. If you got married in 2014, continue to Table 4, later. Otherwise, check the **"No"** box on Form 8962, line 9, and continue to line 10.

STEP 4: Complete if You are Claiming the Personal Exemption for an Individual Another Taxpayer Enrolled in a Policy

4. Did the policy cover at least one individual in your tax family **but** whom another person enrolled in the policy **AND** cover at least one individual not in your tax family?

☐ **Yes.** You must allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

☐ **No.** Continue to Step 5.

STEP 5: Complete for Other Allocation Scenarios

5.a. Did the policy cover at least one individual in your tax family **AND** cover at least one individual **not** in your tax family?

☐ **Yes.** Continue to question 5b.

☐ **No. STOP.** You do not need to complete Part 4. If you got married in 2014, continue to Table 4, later. Otherwise, check the **"No"** box on Form 8962, line 9, and continue to line 10.

b. Does the information provided to the Marketplace at enrollment regarding who would claim the personal exemptions for covered individuals match who will claim the personal exemptions for those individuals for 2014 (answer **"Yes"** if you did not have to provide this information at enrollment)?

☐ **Yes.** Continue to question 5c.

☐ **No.** You must allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

c. Did each tax family receive a separate Form 1095-A **AND** did each Form 1095-A have the correct applicable SLCSP premium for each tax family for each month in Part III, column B?

☐ **Yes. STOP.** You do not need to complete Part 4. If you got married in 2014, continue to Table 4, later. Otherwise, check the **"No"** box on Form 8962, line 9, and continue to line 10.

☐ **No.** You may have to allocate the policy amounts. Check the **"Yes"** box on Form 8962, line 9, and skip to *Part 4—Shared Policy Allocation*.

Table 4. **Alternative Calculation for Year of Marriage Eligibility**

Answer questions 1–5 below to determine whether you may be eligible to elect the alternative calculation for year of marriage.

1 Were you married on December 31, 2014?

☐ **Yes.** Continue to the next question in this table.

☐ **No.** You are not eligible to elect the alternative calculation. Check the **"No"** box on Form 8962, line 9, and continue to line 10.

2 Are you filing a joint return with your spouse for 2014?

☐ **Yes.** Continue to the next question in this table.

☐ **No.** You are not eligible to elect the alternative calculation. Check the **"No"** box on Form 8962, line 9, and continue to line 10.

3 Were you and your spouse each unmarried on January 1, 2014?

☐ **Yes.** Continue to the next question in this table.

☐ **No.** You are not eligible to elect the alternative calculation. Check the **"No"** box on Form 8962, line 9, and continue to line 10.

4 Was anyone in your tax family enrolled in a qualified health plan before your first full month of marriage? (For example, if you got married on July 15, your first full month of marriage was August.)

☐ **Yes.** Continue to the next question in this table.

☐ **No.** You are not eligible to elect the alternative calculation. Check the **"No"** box on Form 8962, line 9, and continue to line 10.

5 Was APTC paid for anyone in your tax family during 2014?

☐ **Yes.** Continue to Worksheet 2 next to determine whether excess APTC was paid during 2014. If excess APTC was paid, you are eligible to elect the alternative calculation. If the amount you entered on Form 8962, line 5, is more than 400, do not complete Worksheet 2. See *Alternative Calculation for Year of Marriage* in Pub. 974 to determine if electing the alternative calculation reduces your repayment amount.

☐ **No.** You are not eligible to elect the alternative calculation. Do not complete Part 5. If you did not complete Part 4, check the **"No"** box on line 9 and continue to line 10. If you completed Part 4, check the **"No"** box on line 10, skip line 11, and continue to *Lines 12 through 23—Monthly Calculation*, later.

Worksheet 2. **Alternative Calculation for Marriage Eligibility**

Complete this worksheet to determine whether you received excess APTC in 2014.

⚠ *If* Part 4—Shared Policy Allocation *applies to you, do* ***not*** *complete this worksheet until you have completed Part 4.*

Monthly Calculation	A. Form(s) 1095-A, lines 21–32, column A*	B. Form(s) 1095-A, lines 21–32, column B**	C. Form 8962, line 8b	D. Subtract column C from column B	E. Smaller of column A or column D	F. Form(s) 1095-A, lines 21–32, column C***
1 January						
2 February						
3 March						
4 April						
5 May						
6 June						
7 July						
8 August						
9 September						
10 October						
11 November						
12 December						
13 **Totals:** Enter the total of column E, lines 1–12						

14 Is line 13, column E, less than line 13, column F?

☐ **Yes.** Excess APTC was paid in 2014. You are eligible to elect the alternative calculation. See *Alternative Calculation for Year of Marriage* in Pub. 974 to determine if electing the alternative calculation reduces your repayment amount.

☐ **No.** There was no excess APTC paid in 2014. You are not eligible to elect the alternative calculation. Do not complete Part 5.

- If you did not complete Part 4, check the **"No"** box on line 9 and continue to line 10. If you are required to use lines 12 through 23 of Form 8962, enter the amounts from lines 1 through 12 of this worksheet in the lines for the corresponding months and columns on Form 8962.
- If you completed Part 4, check the **"No"** box on line 10, skip line 11, and enter the amounts from lines 1 through 12 of this worksheet in the lines for the corresponding months and columns of lines 12 through 23 of Form 8962.

**See Column A under* Lines 12 through 23—Monthly Calculation, *later, for instructions for the amounts to enter on lines 1 through 12, column A, of this worksheet. These are the amounts of the monthly premiums reported on Form(s) 1095-A, lines 21 through 32, column A.*

***See Column B under* Lines 12 through 23—Monthly Calculation, *later, for instructions for the amounts to enter on lines 1 through 12, column B, of this worksheet. These are the amounts of the monthly premium for the applicable SLCSP reported on Form(s) 1095-A, lines 21 through 32, column B.*

****See Column F under* Lines 12 through 23—Monthly Calculation, *later, for instructions for the amounts to enter on lines 1 through 12, column F, of this worksheet. These are the amounts of the monthly APTC reported on Form(s) 1095-A, lines 21 through 32, column C.*

Line 10

Full-year coverage with no changes on Form 1095-A, Part III, columns A or B. Check the **"Yes"** box on line 10 if all of the following apply for each Form 1095-A you received. Otherwise, check the **"No"** box.

- You had coverage for all 12 months during 2014 (January through December).
- The same amount is reported in column A, lines 21 through 32.
- The same amount is reported in column B, lines 21 through 32.
- Your coverage family did not change for any month in 2014. See *Exceptions* below if your coverage family changed during 2014 and you did not notify the Marketplace.

Note. If you got married during 2014, check the **"No"** box unless you got married in December.

Exceptions. If during 2014, your coverage family changed and you did not notify the Marketplace, the premium for the applicable SLCSP reported on your Form(s) 1095-A, Part III, column B, may not be accurate. Your coverage family and premium for the applicable SLCSP may change for any month and any following months that one of the following applies.

- You enroll an individual newly added to your tax family (for example, a newborn).
- An individual in your tax family is no longer enrolled in your qualified health plan.
- An individual included in your coverage family becomes eligible for or loses eligibility for employer coverage or other minimum essential coverage.
- You will claim the personal exemption for an individual, but you did not indicate to the Marketplace at enrollment that you would do so.
- You indicated to the Marketplace at enrollment that you would claim the personal exemption for an individual, but you will not claim a personal exemption for that individual.
- An individual enrolled in the coverage died but you did not remove the individual from the policy.
- You moved during the year.

If any of the above apply and you did not notify the Marketplace, you must determine the correct premium for the applicable SLCSP for the months affected. See Pub. 974 for information on determining the correct premium for the applicable SLCSP or, if you enrolled through the Federally-facilitated Marketplace, go to *www.healthcare.gov/taxes*. See the examples next.

If you checked the **"Yes"** box on line 10, complete line 11. If you checked the **"No"** box, complete lines 12–23.

Example 1. Mike and Susan enroll together in a qualified health plan through the Marketplace. They receive a Form 1095-A, which reports $800 for the enrollment premium in column A on lines 21 through 32 and $850 for the applicable SLCSP premium in column B on lines 21 through 32, for January through December. They check the **"Yes"** box on line 10 and complete line 11 because there is an amount for all 12 months and the amounts did not change for each of columns A and B.

Example 2. Same facts as *Example 1* above, but starting on August 1, Mike is eligible for Medicare and does not notify the Marketplace. Because Mike is eligible for other minimum essential coverage, their coverage family changed starting in August. As a result, Mike and Susan must update the premium for the applicable SLCSP reported in column B for the months of August through December (Form 1095-A, lines 28 through 32, column B). Since there will be a change for some months in column B, Mike and Susan must complete lines 12 through 23. Mike and Susan determine that the premium for the applicable SLCSP for the coverage family of one (Susan) for August through December is $400 each month. Mike and Susan enter $850 in Form 8962, lines 12 through 18, column B, and $400 in lines 19 through 23, column B. Mike and Susan do not complete line 11.

Example 3. Lee receives a Form 1095-A, which reports in column A $1,000 on lines 21 through 32 for January through December and in column B $900 on lines 21 through 31 for January through November. However, column B reports $650 on line 32 because an individual included in Lee's coverage family was eligible for other minimum essential coverage for the entire month of December and Lee reported the change to the Marketplace. Lee checks the **"No"** box on line 10 and completes lines 12 through 23.

If you were enrolled in a qualified health plan for fewer than 12 months during 2014 (for example, you enrolled in January for coverage effective February 1), check the **"No"** box on line 10, and complete lines 12 through 23.

Line 11—Annual Calculation

If you checked the **"No"** box on line 6 or you are using filing status married filing separately and *Situation 2*, earlier, does not apply to you, skip columns A through E, and see *Column F*, later.

Column A. Enter the annual premiums from Form 1095-A, line 33, column A. If you have more than one Form 1095-A, add the amounts together and enter the total on Form 8962, line 11, column A. This amount is the total of your enrollment premiums for the year, including the portion paid by APTC.

If you or a member of your tax family were enrolled in a stand-alone dental plan that provided pediatric benefits, the portion of the dental plan premiums for the pediatric benefits will be included in the amount on Form 1095-A, column A.

Column B. Enter the annual premium for the applicable SLCSP from Form 1095-A, line 33, column B. If you have more than one Form 1095-A, enter the following amount.

- If individuals in your coverage family enrolled in more than one policy in the same state you will receive a Form 1095-A for each policy. Enter the amount from column B of **only one** Form 1095-A. The Marketplace will enter the same SLCSP premium that applies to all members of your coverage family on each Form 1095-A. However, if you got married in December of 2014 and you and your spouse, or individuals in your and your spouse's tax families, were enrolled in separate qualified health plans, add the amounts from Form 1095-A, column B, for each plan (or plans) and enter the total.
- For individuals enrolled in qualified health plans in different states, add together the amounts from column B of the Forms 1095-A from each state and enter the total on Form 8962, line 11, column B.

If during 2014, your coverage family changed and you did not notify the Marketplace, or no APTC was paid, the premium for the applicable SLCSP reported on your Form(s) 1095-A may not be accurate (or may not be reported by the Marketplace). If you must determine a different premium for the applicable SLCSP than what is reported on Form 1095-A for any month, you cannot complete line 11. You must complete lines 12 through 23. See *Exceptions* under *Line 10* above to determine whether you must enter a different amount for the premium for the applicable SLCSP for any month reported on Form 1095-A.

Column C. Enter the amount from line 8a of Form 8962.

Column D. If column D is zero or less, enter -0-.

Column E. Enter the lesser of the amount in column A and the amount in column D.

Column F. Enter the APTC amount from Form 1095-A, line 33, column C. If you have more than one Form 1095-A, add the amounts together and enter the total on Form 8962, line 11, column F.

Not an applicable taxpayer. If you are not an applicable taxpayer because your household income is over 400% of the Federal poverty line or you are using filing status married filing separately and *Situation 2*, earlier, does not apply to you, you cannot take the PTC. You must repay the APTC entered on line 11, column F. To complete the rest of the form, skip lines 12 through 24, and enter the amount from line 11, column F, on lines 25 and 27. Then complete lines 28 (if it applies to you) and 29. Enter the amount from line 29 on your Form 1040, line 46; Form 1040A, line 29; or Form 1040NR, line 44.

Lines 12 through 23—Monthly Calculation

If you checked the **"No"** box on line 6 and you did not elect the alternative calculation for year of marriage **or** you are using filing status married filing separately and *Situation 2*, earlier, does not apply to you, skip columns A through E, and see *Column F*, later.

Column A. Enter on lines 12 through 23, column A, the amount of the monthly premiums reported on Form 1095-A, lines 21 through 32, column A, for the corresponding month. If you have more than one Form 1095-A affecting a particular month, add the amounts together for that month and enter the total on the appropriate line on Form 8962, column A. This amount is the total of your enrollment premiums for the month, including the portion paid by APTC.

If a -0- appears on Form 1095-A, on any of lines 21 through 32, column A, you are not entitled to a monthly credit amount for that month because enrollment premiums were not paid. Enter -0- on the appropriate line on Form 8962, column A.

If you completed Part 4—Shared Policy Allocation for any Form 1095-A, include only the monthly premium amounts allocated to you, if any, using the allocation percentage you entered on lines 30 through 33, column e, and combine those amounts with the monthly premiums for other policies that you did not allocate.

Column B. Enter on lines 12 through 23, column B, the amount of the monthly premium for the applicable SLCSP reported on Form 1095-A, lines 21 through 32, column B, for the corresponding month. If you have more than one Form 1095-A affecting a particular month, enter the following amounts on the appropriate line on Form 8962, column B, for that month.

- For individuals enrolled in separate policies in the same state, the Marketplace will report on each Form 1095-A issued the single applicable SLCSP premium that applies to all members of the 1095-A recipient's coverage family for coverage that same month. Enter this amount on Form 8962, lines 12 through 23, column B. See *Marriage in 2014*, later, if you got married during 2014.
- For individuals enrolled in qualified health plans in different states, add the amounts from column B of Forms 1095-A together and enter the total on Form 8962, lines 12 through 23, column B.
- If you completed Part 4—Shared Policy Allocation for any Form 1095-A, add the amounts of the premium for the applicable SLCSP allocated to you, if any, using the allocation percentage you entered on Form 8962, lines 30 through 33, column f, to the amount of the premium for your applicable SLCSP shown on the Form(s) 1095-A that you did not allocate.

If a -0- appears on Form 1095-A, on any of lines 21 through 32, column B, you are not entitled to a monthly credit amount for that month because enrollment premiums were not paid. Enter -0- on the appropriate line on Form 8962, column B.

If during 2014, your coverage family changed and you did not notify the Marketplace, the premium for the applicable SLCSP reported on your Form(s) 1095-A may not be accurate. See *Exceptions* under *Line 10*, earlier, to determine whether you must enter a different amount for the premium for the applicable SLCSP for any month reported on Form 1095-A. If no APTC was paid, the Marketplace may not report a premium for the SLCSP (Form 1095-A, lines 21 through 32, column B, may be blank). You must determine the premium for your applicable SLCSP to take the PTC on your tax return. See Pub. 974 for information on determining the correct premium for the applicable SLCSP or, if you enrolled through the Federally-facilitated Marketplace, go to *www.healthcare.gov/taxes*.

Marriage in 2014. If you got married in 2014 and you and your spouse (or individuals in your tax family) were enrolled in separate qualified health plans during months prior to your first full month of marriage, add together the amounts from Form 1095-A, column B, for each plan (or plans) and enter the total. If you completed Part 5—Alternative Calculation for Year of Marriage, use the instructions in Pub. 974 for the entries to make for your pre-marriage months.

Column C. If you did not complete Part 5—Alternative Calculation for Year of Marriage, enter on lines 12 through 23, column C, your monthly contribution amount from line 8b. If columns A and B of any of lines 12 through 23 are blank, leave column C of the corresponding line blank.

If you completed Part 5—Alternative Calculation for Year of Marriage, see Pub. 974 for how to complete column C.

Column D. If an entry for column D is zero or less, enter -0-.

Column E. Generally, enter for each month the lesser of the amount in column A and the amount in column D for that month.

Column F. Enter on lines 12 through 23, column F, the amount of the monthly APTC reported on Form 1095-A, lines 21 through 32, column C. If you have more than one Form 1095-A affecting a particular month, add the amounts together for that month and enter the total on the appropriate line on Form 8962, column F.

If you completed Part 4—Shared Policy Allocation for any Form 1095-A, include only the amounts of the monthly APTC allocated to you, if any, using the allocation percentage you entered on lines 30 through 33, column g, and combine that amount with the amounts of the monthly APTC for other policies that you did not allocate.

Not an applicable taxpayer. If you are not an applicable taxpayer because your household income is over 400% of the Federal poverty line or you are using filing status married filing separately and *Situation 2*, earlier, does not apply to you, you must repay the total APTC entered on lines 12 through 23, column F (unless the alternative calculation for marriage rule applies to you and you are able to reduce your repayment amount). To complete the rest of the form, skip line 24, and enter the total of lines 12 through 23, column F, on lines 25 and 27. Then complete lines 28 (if it applies to you) and 29. Enter the amount from line 29 on your Form 1040, line 46; Form 1040A, line 29; or Form 1040NR, line 44.

Example. Melissa and Ryan were married at the beginning of 2014. They have no dependents. They were enrolled under the same qualified health plan through a Marketplace from January through April. Monthly APTC of $1,000 was paid for them, for a total of $4,000. They divorced April 10. Melissa enrolled in single coverage from May through December. Monthly APTC of $100 was paid for her, for a total of $800. Ryan did not enroll in coverage.

At the end of the year, Melissa or Ryan will receive a Form 1095-A reporting their coverage for January through April. The recipient of the Form 1095-A should provide a copy to the non-recipient. Melissa will receive a Form 1095-A reporting her coverage for May through December.

For 2014, Melissa's family size is one and her household income is 450% of the Federal poverty line. Ryan's family size is one and his household income is 410% of the Federal poverty line. Melissa and Ryan agree to allocate the APTC 60% to Melissa and 40% to Ryan. The allocation is only for the period of time Melissa and Ryan were married. The sum of the APTC allocated to Melissa is $2,400 ($1,000 x .6 x 4 months). Melissa must add this sum to her APTC of $800 for her single coverage. She enters the monthly amounts on lines 12–23, column F, and the total of $3,200 on Form 8962, lines 25, 27, and 29. Melissa enters the amount from line 29 on the applicable line of her tax return.

The sum of the APTC allocated to Ryan is $1,600 ($1,000 x .4 x 4 months). Ryan enters the monthly amounts on Form 8962, lines 12–23, column F, and the total of $1,600 on lines 25, 27, and 29. Ryan enters the $1,600 from line 29 on the applicable line of his tax return.

Individual you enrolled for whom no taxpayer will claim a personal exemption. If no taxpayer claims a personal exemption for an individual you enrolled in a qualified health plan (including yourself), you must report any APTC paid for the individual if you indicated to the Marketplace at enrollment that you would claim the individual's personal exemption. Follow the rules in *Column F*, earlier, to report this APTC.

Line 26

If line 24 is greater than line 25, subtract line 25 from line 24 and enter the result on line 26. This result is the amount of your PTC that is more than the APTC paid. This amount will reduce the amount of tax you must pay with your tax return or increase your refund. Also enter the result on your tax return as instructed on Form 8962, and skip lines 27 through 29. If line 24 is equal to line 25, enter -0- on line 26 and skip lines 27 through 29.

If you elected the alternative calculation for year of marriage, and line 24 is greater than line 25, enter -0- on line 26 and skip lines 27 through 29.

If line 25 is greater than line 24, skip line 26 and go to Part 3.

Part 3—Repayment of Excess Advance Payment of the Premium Tax Credit

Complete this part to figure the amount of excess APTC you must repay.

If one of the following applies, you must repay a portion or all of the APTC paid for you or a member of your tax family.

- You checked the **"No"** box on line 6. This means you entered a percentage of more than 400 on line 5 and you are not an applicable taxpayer eligible for the PTC. Enter the amount from Form 8962, line 25, on lines 27 and 29.
- Line 25 is greater than line 24. You have excess APTC. Go to line 27 of Form 8962 to figure the amount of your excess APTC.
- You are married at the end of 2014 but you are filing your return as married filing separately and did not check the **"Relief"** box because you are not a victim of domestic abuse or spousal abandonment.

Line 28

The excess APTC you must repay is limited to the amounts in Table 5 next. Enter the appropriate amount from Table 5 on line 28. If you were married at the end of 2014 but are filing separately from your spouse, the repayment limitation shown in Table 5 applies to you and your spouse separately based on the household income reported on each return.

If your entry on Form 8962, line 5, is 400 or more, there is no repayment limitation. You must repay the amount shown on line 27. Leave line 28 blank and enter the amount from line 27 on line 29.

Table 5. **Repayment Limitation**

IF the amount on Form 8962, line 5 is . . .	**ENTER** on line 28 . . .	
	for a filing status of Single—	for any other filing status—
Less than 200	$300	$600
At least 200 but less than 300	$750	$1,500
At least 300 but less than 400	$1,250	$2,500
400 or more	leave line 28 blank	

Part 4—Shared Policy Allocation

You must complete Part 4 if both of the following apply.

- You checked the **"Yes"** box on line 9.
- Table 3 instructed you to allocate your policy amounts (one or more of the amounts in the columns in Part III of Form 1095-A) based on one of your answers to the questions in Steps 1 through 5 of the table.

To complete Part 4 for a qualified health plan, see *Specific Allocation Situations*, later, to find the situation (or situations) that applies to that policy. The instructions for each situation will describe the amounts you must allocate and your allocation options. Then see *Lines 30 through 33, columns a through g*, later, to use that information to complete the line(s) on Form 8962 that correspond to each qualified health plan.

Multiple allocations of one qualified health plan. You may have to allocate policy amounts from one qualified health plan among more than two tax families in the same month. You may also have to allocate amounts from one qualified health plan using more than one of the rules (either in the same month or in different months) under *Specific Allocation Situations*, later.

Multiple allocations in the same month. If one qualified health plan covers individuals from more than two tax families in the same month, use the worksheets and instructions necessary to allocate the amounts on Form 1095-A for that month that are in Pub. 974 under *Shared Policy Allocation*.

Example. One qualified health plan covers Bret, his spouse Maryanne, and their daughter Sophia from January through August. Bret and Maryanne divorce on August 26. Bret and Maryanne each file a tax return using a filing status of single. Sophia is claimed as a dependent by her grandfather, Mike. Bret, Maryanne, and Mike must allocate the amounts from Form 1095-A for the months of January through August on their tax returns using the worksheets and instructions in Pub. 974.

Multiple allocations in different months. If more than one of the allocation rules under *Specific Allocation Situations*, later, applies to the same qualified health plan for different months, you must use the rule (or rules if more than one rule applies in the same month – see *Multiple allocations in the same month* above) that applies for that month to allocate the amounts on Form 1095-A.

Example. Henry enrolled himself, his spouse, Cara, and their two dependent children, Heidi and Matt, in a policy for 2014. APTC was paid on behalf of each. The couple divorced on June 30, and Cara purchased different health insurance for July through December in which she enrolls with Heidi and Matt. Henry claims Heidi as a dependent on his tax return. Cara claims Matt as a dependent on her tax return. For the months Henry and Cara were married (January through June), they will allocate the amounts from the policy on line 30 using the rules under *Taxpayers divorced or legally separated in 2014*, later. For the months Henry and Cara were divorced (July through

Table 6. **Specific Allocation Situations Chart**

The steps in this chart refer to the steps in Table 3, earlier.
Step 1. If you answered **"Yes"** to question 1, see *Taxpayers divorced or legally separated in 2014* below.
Step 2. If you answered **"Yes"** to question 2, see *Taxpayers married at year end but filing separate returns* below.
Step 3. If you answered **"Yes"** to question 3b, see *Policy shared with an individual for whom another taxpayer claims a personal exemption*, later.
Step 4. If you answered **"Yes"** to question 4, see *Policy shared with an individual for whom another taxpayer claims a personal exemption*, later.
Step 5. If you answered **"No"** to question 5b, see *Policy shared by two or more tax families*, later. If you answered **"No"** to question 5c, follow the bulleted item below that applies. • If at enrollment, you enrolled an individual in a policy expecting to claim the personal exemption for the individual, but for 2014 another taxpayer will claim the personal exemption for that individual, see *Policy shared with an individual for whom another taxpayer claims a personal exemption*, later. • If you and at least one other tax family enrolled in a single qualified health plan and a separate Form 1095-A was not issued to each tax family, or the correct applicable SLCSP premium for at least one tax family for at least one month is different than the amount reported on Form 1095-A, Part III, column B, see *Policy shared by two or more tax families*, later.

December), they will allocate the amounts from the policy on line 31 using the rules under *Policy shared with an individual for whom another taxpayer claims a personal exemption*, later.

Taxpayer allocated entire policy. Do not complete Part 4 if you agree to allocate all of the amounts shown on one Form 1095-A to one taxpayer under the rules of *Taxpayers divorced or legally separated in 2014* below or *Policy shared with an individual for whom another taxpayer claims a personal exemption*, later. If you are the taxpayer allocated one hundred percent of the amounts from Form 1095-A, use the general rules under *Line 11—Annual Calculation* or *Lines 12 through 23—Monthly Calculation*, earlier, to report the amounts. If you are the taxpayer allocated zero percent of the amounts from Form 1095-A, do not report anything on Form 8962, and do not file Form 8962 unless you are taking the PTC or reconciling APTC reported on another Form 1095-A.

Specific Allocation Situations

Table 6 above will direct you to the instructions for allocating policy amounts.

Taxpayers divorced or legally separated in 2014. You and your former spouse must allocate policy amounts on your separate returns to figure your PTC if both of the following apply.

- You were married at some point during 2014 but were no longer married to that spouse at the end of 2014.
- You and your former spouse were enrolled in the same qualified health plan, or you or an individual in your tax family (as shown on your tax return) was enrolled in the same policy as your former spouse or as an individual in your former spouse's tax family at any time during 2014.

You will allocate with your former spouse a percentage of the total enrollment premiums, the premiums for the applicable SLCSP, and APTC for coverage under the plan during the months you were married. You will find these amounts on your Form(s) 1095-A, Part III, columns A, B, and C, respectively. You and your former spouse can allocate these amounts using any percentage you agree on between zero and one hundred percent, but you must allocate all amounts using the same percentage. If you do not agree on a percentage, you and your former spouse must allocate 50% of each of these amounts to you and 50% of each to your former spouse.

Example 1. Keith and Stephanie are married at the beginning of 2014 and have three children, Ben, Grace, and Max. In January, Keith enrolls Ben, Grace, and Max in a qualified health plan, with an effective coverage date of February 1. Keith and Stephanie divorce in July. The children become eligible for and enroll in government-sponsored health coverage and disenroll from the qualified health plan, effective August 1.

Keith claims Ben and Grace as dependents and Stephanie claims Max as a dependent for 2014. Keith and Stephanie agree to allocate the policy amounts 33% to Stephanie and 67% to Keith. Therefore, 33% of the enrollment premiums, the applicable SLCSP premiums, and APTC are allocated to Stephanie and 67% of these amounts are allocated to Keith. The allocation is only for the months Keith and Stephanie were married.

On her Form 8962, Part 4, line 30, Stephanie enters Keith's social security number in column b and enters "0.33" in columns e, f, and g. On his Form 8962, Part 4, line 30, Keith enters Stephanie's social security number in column b and enters "0.67" in columns e, f, and g. Stephanie and Keith both enter "02" in column c and "07" in column d.

Example 2. The facts are the same as in *Example 1* except that Keith and Stephanie cannot agree on an allocation percentage. Therefore, 50% of the enrollment premiums, the applicable SLCSP premiums, and APTC are allocated to each taxpayer. On their Forms 8962, Part 4, line 30, Keith and Stephanie each enter "0.50" in columns e, f, and g.

Taxpayers married at year end but filing separate returns. You may be able to take the PTC if you file a return as single or head of household (see *Situation 1* under *Married taxpayers*, earlier) or you file a return as married filing separately due to domestic abuse or spousal abandonment (see *Situation 2* under *Married taxpayers*, earlier). You cannot take the PTC if you are filing your return as married filing separately and Situation 2 does not apply. In any of these situations, on your separately filed returns, you and your spouse must equally allocate (50% to each spouse) certain policy amounts if both of the following apply.

- You are married at the end of 2014 but are filing a separate return from your spouse.
- You and your spouse were enrolled in the same qualified health plan, or you or an individual in your tax family was enrolled in the same policy as your spouse or an individual in your spouse's tax family, at any time during 2014.

If you must allocate policy amounts, see *Situation 1 or Situation 2* next, or if neither applies, see *Married filing separately (not in Situation 2)*, later.

If the policy covered individuals in only one spouse's tax family, the spouse whose tax family included the covered individual(s) must report all of the policy amounts (unless the policy must be allocated with another taxpayer).

Situation 1 or Situation 2. You and your spouse have separate tax families, as shown on your separate tax returns. Enter "0.50" in columns e and g of the appropriate line in Part 4 to allocate the enrollment premium and APTC. Leave column f

blank because you do not allocate the premium for the applicable SLCSP. Instead, enter the applicable SLCSP premium for your coverage family on lines 12 through 23. See *Example 1* below and *Example 2*, later.

If you enrolled in coverage in the Marketplace with your spouse or another individual who is not in your tax family, your coverage family and applicable SLCSP premium may be different from the coverage family and applicable SLCSP premium the Marketplace used to determine the amount of your APTC. In that case you must use a different applicable SLCSP premium to calculate your credit than the amount reported on Form 1095-A, Part III, column B. See Pub. 974 for information on determining the correct premium for the applicable SLCSP or, if you enrolled through the Federally-facilitated Marketplace, go to www.healthcare.gov/taxes.

Married filing separately (not in Situation 2). You and your spouse have separate tax families. Enter "0.50" in column g of the appropriate line in Part 4 to allocate the APTC. Leave columns e and f blank because you do not allocate the enrollment premium or premium for the applicable SLCSP. You must repay the APTC allocated to you subject to the limit on line 28 because you are not an applicable taxpayer. See *Example 3* and *Example 4* below.

Example 1. John and Carol are married at the end of 2014 and have one child, Mark. John and Carol enrolled in a qualified health plan for 2014. The plan covered John, Carol, and Mark, with an annual premium of $14,000 and APTC of $8,500, which applied to the coverage for all of the individuals. John moved out of the residence on May 15. Carol and Mark continued to reside at the residence. John and Carol file separate returns for 2014. Carol qualifies to file her return as head of household. John files his return as married filing separately. Carol claims Mark as her dependent. Because Carol and John are not filing a joint return, they each have their own tax families, which are different from the tax family they indicated to the Marketplace when they enrolled. Carol's family size reported on her tax return is now two because John is not in her tax family. Therefore, Carol's Federal poverty line percentage is determined using the modified AGI of her tax family. John's modified AGI is not included because he is not in Carol's tax family.

Carol's family size for 2014 for purposes of computing her contribution amount is two (Carol and her dependent Mark). Because John is not in Carol's tax family, he is not in her coverage family, which consists of Carol and her dependent Mark, for purposes of determining her applicable SLCSP premium. If neither John nor Carol notifies the Marketplace about the change in family circumstances, the Form 1095-A that Carol or John receives will report in column B the premium for the applicable SLCSP that covers Carol, Mark, and John, which will be incorrect. Carol must determine the correct premium for the applicable SLCSP covering Carol and Mark. Carol looks up her correct premium for the applicable SLCSP.

Carol takes into account $7,000 ($14,000 x .50) of the premiums of the plan in which she and Mark were enrolled in figuring her PTC. Carol must then reconcile $4,250 ($8,500 x .50) of the APTC for her coverage. Amounts from this policy are allocated for all months Carol and John were enrolled. On her Form 8962, Part 4, line 30, Carol enters John's social security number in column b and enters "0.50" in columns e and g. Column f is left blank. Instead of allocating the applicable SLCSP premium, Carol will enter the applicable SLCSP premium that applies to her and Mark.

Since John is filing his tax return as married filing separately and no exception to the married filing jointly requirement applies, he is not an applicable taxpayer and must repay the $4,250 APTC allocated to him, subject to the repayment limitations on line 28. On his Form 8962, Part 4, line 30, John enters Carol's social security number in column b and enters "0.50" in column g. John leaves columns e and f blank because he is not an applicable taxpayer and cannot take the PTC.

Example 2. Kevin and Nancy are married at the end of 2014 and have no dependents. Kevin and Nancy are enrolled in a qualified health plan for 2014 with an annual premium of $10,000 and APTC of $6,500. Nancy is a victim of domestic abuse and is unable to file a joint return under the rules outlined in *Situation 2* under *Married taxpayers*, earlier. Nancy files her return using the filing status married filing separately and checks the **"Relief"** box at the top of Form 8962.

Nancy's family size for 2014 for purposes of computing her monthly contribution is one (Nancy). Nancy's coverage family for purposes of determining her applicable SLCSP premium for 2014 also is one (Nancy). If neither Kevin nor Nancy notifies the Marketplace about the change in family circumstances, the Form 1095-A that Kevin or Nancy receives will report in column B the premium for the applicable SLCSP that covers Nancy and Kevin, which will be incorrect. Nancy must determine the correct premium for the applicable SLCSP covering only Nancy. Nancy looks up her correct premium for the applicable SLCSP.

Nancy's Federal poverty line percentage is determined using Nancy's modified AGI and her family size of one. Nancy takes into account $5,000 ($10,000 x .50) of the enrollment premiums in figuring her PTC. Nancy must reconcile $3,250 ($6,500 x .50) of the APTC for her coverage. On her Form 8962, Part 4, line 30, Nancy enters Kevin's social security number in column b and enters "0.50" in columns e and g. Column f is left blank. Instead of allocating the applicable SLCSP premium, Nancy will enter the applicable SLCSP premium that applies to Nancy. Nancy enters this amount on the applicable lines in column B, lines 12 through 23.

Example 3. For 2014, Michael and Colleen are married with no dependents and are enrolled in a qualified health plan. APTC of $8,700 is paid for them during 2014. Michael and Colleen each file their returns for 2014 as married filing separately and Situation 2 does not apply to either of them. Michael and Colleen are not applicable taxpayers and cannot take the PTC. They must allocate the APTC paid of $8,700, one-half (50%) to Michael and one-half (50%) to Colleen. On her Form 8962, Part 4, line 30, Colleen enters Michael's social security in column b and enters "0.50" in column g. On his Form 8962, Part 4, line 30, Michael enters Colleen's social security number in column b and enters "0.50" in column g.

Example 4. The facts are the same as *Example 3* except that only Colleen is covered under the policy. Colleen does not complete Part 4 of her Form 8962. She reports all of the APTC received on line 11 or lines 12 through 23, whichever applies. Michael does not file Form 8962 because he was not enrolled in a qualified health plan.

Policy shared with an individual for whom another taxpayer claims a personal exemption. If you or another person in your tax family was enrolled in a qualified health plan with an individual (for example, your child) for whom another taxpayer claims a personal exemption (for example, you are enrolled with your child but a former spouse claims your child's personal exemption), you must complete Part 4. The taxpayer claiming the personal exemption may be able to take the PTC for the individual's coverage. When you compute the PTC, you must allocate the enrollment premiums and the APTC for coverage of the individual. If you are required to allocate APTC, you also must allocate the applicable SLCSP premium. You also must do this allocation if, at enrollment, you indicated to the Marketplace that you would be a single tax family but are two or more tax families at filing, for example a child claims his or her own personal exemption.

You and the taxpayer claiming the personal exemption may agree on any allocation percentage between zero and one hundred percent. You may use the percentage you agreed on for every month during which this allocation rule applies, or you may agree on different percentages for different months. However, you must use the same allocation percentage for all policy amounts (enrollment premiums, applicable SLCSP premiums, and APTC) in a month. If you cannot agree on an allocation percentage, the allocation percentage is equal to the number of individuals enrolled by you for whom the other taxpayer claims a personal exemption for the tax year divided by the total number of individuals enrolled in the same policy as the individual. The allocation percentage is the percentage that applies to the amounts the taxpayer claiming the personal exemption must use to compute PTC and reconcile it with APTC. You must compute PTC and reconcile APTC using the remaining amounts.

TIP *This allocation rule does not apply if you and one or more other tax families enrolled in a single qualified health plan as two or more tax families and remained two or more tax families for the year. Use* Policy shared by two or more tax families, *later, for instructions on allocating in that situation.*

Note. If APTC is paid for coverage of an individual for whom no taxpayer claims a personal exemption, the taxpayer who attests to the Marketplace to the intention to claim a personal exemption for the individual is responsible for reporting and reconciling the APTC. See *Individual you enrolled for whom no taxpayer will claim a personal exemption* under *Lines 12 through 23—Monthly Calculation*, earlier.

Example 1. Joe and Alice have been divorced since January of 2013 and have two children, Chris and Jane. Joe enrolls in a qualified health plan covering Joe, Chris, and Jane for 2014. The premium for the plan is $13,000. Based on a family size and coverage family of three, and a premium for the applicable SLCSP of $12,000, Joe is approved for and receives APTC computed as follows: Joe's projected household income for 2014 is $58,590 (300% of the Federal poverty line for a family size of three). Joe's APTC for 2014 is $6,434 ($12,000 applicable SLCSP premiums less $5,566 contribution amount (household income $58,590 x applicable figure .095)). Joe's actual household income for 2014 is $58,988.

Jane lives with Alice for more than half of 2014 and Alice claims Jane as a dependent. Joe and Alice agree to an allocation percentage of 20% to determine how much of the total amounts related to the qualified health plan are for Jane's coverage. Therefore, 20% of the enrollment premiums, APTC, and the applicable SLCSP premiums are allocated to Alice and 80% are allocated to Joe.

In computing PTC, Joe takes into account $10,400 of enrollment premiums ($13,000 x .80). Joe must reconcile $5,147 of APTC ($6,434 x .80). Joe's tax family for 2014 includes only Joe and Chris, and Joe's household income of $58,988 is 380% of the Federal poverty line for a family size of two. Joe's applicable SLCSP premium for 2014 is $9,600 (the applicable SLCSP premium covering Joe, Chris, and Jane of $12,000, minus the amount allocated to Alice of $2,400 ($12,000 x .20)).

Joe's PTC for 2014 is $3,996 (the lesser of $3,996, the excess of Joe's applicable SLCSP premium of $9,600 minus the contribution amount of $5,604 ($58,998 x .095), and $10,400, Joe's enrollment premiums). Joe has excess APTC of $1,151 (the excess of the APTC of $5,147 over the PTC of $3,996).

When Joe completes Part 4 of Form 8962, he enters Alice's social security number on line 30, column b, and enters "0.80" in columns e, f, and g.

Alice is responsible for reconciling $1,287 ($6,434 x .20) of APTC for Jane's coverage. If Alice is eligible for the PTC, she will take into account $2,600 ($13,000 x .20) of the enrollment premiums for Jane and $2,400 ($12,000 x .20) of the applicable SLCSP premiums. Alice must compute her contribution amount using the Federal poverty line percentage for the household income and family size reported on her Form 8962.

Example 2. The facts are the same as in *Example 1* except that Joe and Alice do not agree on an allocation percentage. Therefore, the allocation percentage equals the number of individuals Joe enrolled in a qualified health plan for whom Alice claims a personal exemption (1, Jane), divided by the number of individuals enrolled in the plan (3, Joe, Chris, and Jane). The allocation percentage is 33%. Alice is allocated 33% of the enrollment premiums, APTC, and applicable SLCSP premiums and the remaining 67% of each is allocated to Joe.

Policy shared by two or more tax families. If you and one or more other tax families enrolled in a single qualified health plan as two or more tax families and remained two or more tax families for the year, you may have to allocate the enrollment premiums among the families. However, if a family that expects at enrollment to be a single tax family is two or more tax families at filing, for example as a result of a family member claiming his or her own personal exemption, see *Policy shared with an individual for whom another taxpayer claims a personal exemption*, earlier.

Each applicable taxpayer with at least one individual in his or her tax family covered by the plan can take the PTC, if otherwise allowable. PTC for each taxpayer is computed based on each taxpayer's household income, family size, and premium for the applicable SLCSP for the taxpayer's coverage family. However, because there is only one enrollment premium covering all tax families, a portion of the enrollment premiums must be allocated to each tax family. The Marketplace should report on Form 1095-A, Part III, only the amounts that apply to the tax family receiving that Form 1095-A, including in column A only that portion of the enrollment premiums allocated to that tax family. The enrollment premiums are allocated in proportion to the premiums for the applicable SLCSP for each taxpayer's coverage family. Therefore, you must complete Part 4 to allocate enrollment premiums only if:

- The Marketplace did not issue at least one Form 1095-A for each tax family (which may happen if no APTC is paid for any tax family), or
- The correct applicable SLCSP premium for at least one tax family for at least one month is different than the amount reported on Form 1095-A.

If the Marketplace furnishes only one Form 1095-A, the taxpayer receiving the Form 1095-A should provide a copy to the other taxpayers. You and the other taxpayer(s) must complete only column e on the appropriate line in Part 4 to allocate the enrollment premiums to each family.

Example. Gary and his 25-year-old nondependent son Jim enroll in a qualified health plan. Jim has no dependents. The policy covers Gary, Jim, and Gary's two young daughters who are Gary's dependents. No APTC is paid for this policy. The Form 1095-A furnished by the Marketplace to Gary shows an enrollment premium of $15,000 for the year and shows either an applicable SLCSP premium for a coverage family that incorrectly includes Gary, Gary's daughters, and Jim or does not report an applicable SLCSP premium. Gary and Jim determine that the premium for the applicable SLCSP covering Gary and his two dependents is $12,000 and the premium for the applicable SLCSP covering Jim is $6,000. Gary and Jim are applicable taxpayers and each can take the PTC.

Gary computes his credit using his household income and family size of three, and the applicable SLCSP premium for a coverage family of three of $12,000. Jim computes his credit

using his household income and family size of one, and the applicable SLCSP premium for a coverage family of one of $6,000.

Gary and Jim must allocate the enrollment premium of $15,000 reported on the Form 1095-A, Part III, column A, in proportion to each taxpayer's applicable SLCSP premium as follows. Gary's allocated enrollment premium is $10,000 ($15,000 x $12,000/$18,000) (67% of the total premium of $15,000) and Jim's allocated enrollment premium is $5,000 ($15,000 x $6,000/$18,000) (33% of the total premium of $15,000).

Gary enters Jim's social security number on line 30, column b, and enters "0.67" in column e. Jim enters Gary's social security number on line 30, column b, and enters "0.33" in column e. Gary and Jim leave line 30, columns f and g, blank.

Lines 30 through 33, columns a through g

If you shared a policy with another taxpayer in one of the situations described in *Specific Allocation Situations*, earlier, complete line 30, columns a through g, as applicable. If you shared a policy with another taxpayer and you are not making an allocation in all three columns, e, f, and g, leave the column blank that does not apply.

If you shared multiple policies during the year or must do more than one allocation for a single policy, complete lines 31 through 33 for each separate allocation, as needed. For instructions on making more than four separate allocations, see *Line 34*, later.

Not an applicable taxpayer. If you are not an applicable taxpayer because your household income is over 400% of the Federal poverty line or you are using filing status married filing separately and *Situation 2*, earlier, does not apply to you, you cannot take the PTC. Unless you are electing the alternative calculation for year of marriage, do not enter any percentages in columns e or f when completing Part 4.

Lines 30 through 33, column a. Enter the Marketplace-assigned policy number from Form 1095-A, line 2. If the policy number of the Form 1095-A is more than 15 characters, enter only the last 15 characters.

Lines 30 through 33, column b. Enter the social security number of the taxpayer with whom you are allocating policy amounts. This social security number may or may not be reported on your Form 1095-A, depending on your relationship to the other taxpayer.

Lines 30 through 33, column c. Enter the first month you are allocating policy amounts. For example, if you were enrolled in a policy with your former spouse from January through June, enter "01" in column c.

Lines 30 through 33, column d. Enter the last month you are allocating policy amounts. For example, if you were enrolled in a policy with your former spouse from January through June, enter "06" in column d.

Lines 30 through 33, column e. If your allocation situation requires you to allocate the enrollment premiums on Form 1095-A, lines 21 through 32, column A, enter your allocation percentage for that policy in column e. Enter your allocation percentage as a decimal rounded to two places (for example, for 40%, enter 0.40). Otherwise, leave column e blank.

Lines 30 through 33, column f. If your allocation situation requires you to allocate the premium for the applicable SLCSP on Form 1095-A, lines 21 through 32, column B, enter your allocation percentage for that policy in column f. Enter your allocation percentage as a decimal rounded to two places (for example, for 67%, enter 0.67). You will enter an allocation percentage in column f, in the following two circumstances.

- You allocated the policy amounts under *Taxpayers divorced or legally separated in 2014*, earlier.
- You allocated the policy amounts under *Policy shared with an individual for whom another taxpayer claims a personal exemption*, earlier, **and** APTC was paid for an individual covered by the policy who was **not** in your tax family.

Leave column f blank in all other allocation situations because you do not allocate the premiums for the applicable SLCSP reported in those situations. Instead, you must determine the correct applicable SLCSP premium for your coverage family and enter that amount on Form 8962, lines 12 through 23, column B. See Pub. 974 for information on determining the correct premium for the applicable SLCSP or, if you enrolled through the Federally-facilitated Marketplace, go to *www.healthcare.gov/taxes*.

Lines 30 through 33, column g. If your allocation situation requires you to allocate the APTC on Form 1095-A, lines 21 through 32, column C, enter your allocation percentage for that policy in column g. Enter your allocation percentage as a decimal rounded to two places (for example, for 80%, enter 0.80). Otherwise, leave column g blank.

Line 34

If you have completed your required allocations of policy amounts shown on Forms 1095-A using lines 30 through 33, check the **"Yes"** box on line 34. If you must make more than four allocations of policy amounts shown on Forms 1095-A, check the **"No"** box on line 34 and attach a statement to your return providing the information shown on lines 30 through 33, columns a through g for each additional allocation.

If you got married in 2014 and APTC was paid for an individual in your tax family, see Table 4 under *Line 9* in the instructions for Part 2, earlier. Otherwise, check the **"No"** box on Form 8962, line 10, skip line 11, and continue to *Lines 12 through 23—Monthly Calculation* in the instructions for Part 2, earlier.

Part 5—Alternative Calculation for Year of Marriage

Complete Part 5 to elect the alternative calculation for your pre-marriage months. Electing the alternative calculation is optional, but may reduce the amount of excess APTC you must repay. To be eligible to make this election, you must meet either of the following conditions.

- You checked the **"No"** box on Form 8962, line 6, **and** you answered "Yes" to all 5 questions in Table 4, earlier.
- You checked the **"Yes"** box on Form 8962, line 6, **and** the **"Yes"** box on line 14 of Worksheet 2, earlier.

If you, your spouse, or any individual in your tax family had coverage under a qualified health plan for at least one month before your first full month of marriage, use the worksheets and instructions necessary to compute the alternative calculation that are in Pub. 974 under *Alternative Calculation for Year of Marriage*.

Do not go to Pub. 974 until you have completed Table 4, earlier, to determine whether you meet the requirements to elect the alternative calculation.

Line 35. Complete line 35, columns a through d as indicated in Pub. 974 under *Alternative Calculation for Year of Marriage.*

Line 36. Complete line 36, columns a through d as indicated in Pub. 974 under *Alternative Calculation for Year of Marriage.*

Form **1040** Department of the Treasury—Internal Revenue Service (99) **U.S. Individual Income Tax Return** **2014** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2014, or other tax year beginning , 2014, ending , 20 See separate instructions.

Your first name and initial	Last name	Your social security number
If a joint return, spouse's first name and initial	Last name	Spouse's social security number
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		Presidential Election Campaign: Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/state/county / Foreign postal code	

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

c **Dependents:** (1) First name / Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

Boxes checked on 6a and 6b
No. of children on 6c who:
• **lived with you**
• **did not live with you due to divorce or separation (see instructions)**
Dependents on 6c not entered above
Add numbers on lines above ▶

d Total number of exemptions claimed

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2		7
8a	**Taxable** interest. Attach Schedule B if required		8a
b	**Tax-exempt** interest. **Do not** include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required		9a
b	Qualified dividends	9b	
10	Taxable refunds, credits, or offsets of state and local income taxes		10
11	Alimony received		11
12	Business income or (loss). Attach Schedule C or C-EZ		12
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		13
14	Other gains or (losses). Attach Form 4797		14
15a	IRA distributions 15a	b Taxable amount	15b
16a	Pensions and annuities 16a	b Taxable amount	16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E		17
18	Farm income or (loss). Attach Schedule F		18
19	Unemployment compensation		19
20a	Social security benefits 20a	b Taxable amount	20b
21	Other income. List type and amount		21
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶		22

Adjusted Gross Income

23	Educator expenses	23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24	
25	Health savings account deduction. Attach Form 8889	25	
26	Moving expenses. Attach Form 3903	26	
27	Deductible part of self-employment tax. Attach Schedule SE	27	
28	Self-employed SEP, SIMPLE, and qualified plans	28	
29	Self-employed health insurance deduction	29	
30	Penalty on early withdrawal of savings	30	
31a	Alimony paid b Recipient's SSN ▶	31a	
32	IRA deduction	32	
33	Student loan interest deduction	33	
34	Tuition and fees. Attach Form 8917	34	
35	Domestic production activities deduction. Attach Form 8903	35	
36	Add lines 23 through 35		36
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶		37

Tax and Credits

	38	Amount from line 37 (adjusted gross income)		38
	39a	Check if: ☐ **You** were born before January 2, 1950, ☐ Blind. ☐ **Spouse** was born before January 2, 1950, ☐ Blind. **Total boxes checked ▶ 39a**		
	b	If your spouse itemizes on a separate return or you were a dual-status alien, check here ▶ **39b** ☐		
Standard Deduction for— • People who check any box on line 39a or 39b **or** who can be claimed as a dependent, see instructions. • All others: Single or Married filing separately, $6,200 Married filing jointly or Qualifying widow(er), $12,400 Head of household, $9,100	40	**Itemized deductions** (from Schedule A) **or** your **standard deduction** (see left margin)		40
	41	Subtract line 40 from line 38		41
	42	**Exemptions.** If line 38 is $152,525 or less, multiply $3,950 by the number on line 6d. Otherwise, see instructions		42
	43	**Taxable income.** Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-		43
	44	**Tax** (see instructions). Check if any from: **a** ☐ Form(s) 8814 **b** ☐ Form 4972 **c** ☐		44
	45	**Alternative minimum tax** (see instructions). Attach Form 6251		45
	46	Excess advance premium tax credit repayment. Attach Form 8962		46
	47	Add lines 44, 45, and 46 ▶		47
	48	Foreign tax credit. Attach Form 1116 if required	48	
	49	Credit for child and dependent care expenses. Attach Form 2441	49	
	50	Education credits from Form 8863, line 19	50	
	51	Retirement savings contributions credit. Attach Form 8880	51	
	52	Child tax credit. Attach Schedule 8812, if required	52	
	53	Residential energy credits. Attach Form 5695	53	
	54	Other credits from Form: **a** ☐ 3800 **b** ☐ 8801 **c** ☐	54	
	55	Add lines 48 through 54. These are your **total credits**		55
	56	Subtract line 55 from line 47. If line 55 is more than line 47, enter -0- ▶		56

Other Taxes

57	Self-employment tax. Attach Schedule SE		57
58	Unreported social security and Medicare tax from Form: **a** ☐ 4137 **b** ☐ 8919		58
59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required		59
60a	Household employment taxes from Schedule H		60a
b	First-time homebuyer credit repayment. Attach Form 5405 if required		60b
61	Health care: individual responsibility (see instructions) Full-year coverage ☐		61
62	Taxes from: **a** ☐ Form 8959 **b** ☐ Form 8960 **c** ☐ Instructions; enter code(s)		62
63	Add lines 56 through 62. This is your **total tax** ▶		63

Payments

If you have a qualifying child, attach Schedule EIC.

64	Federal income tax withheld from Forms W-2 and 1099	64	
65	2014 estimated tax payments and amount applied from 2013 return	65	
66a	**Earned income credit (EIC)**	66a	
b	Nontaxable combat pay election **66b**		
67	Additional child tax credit. Attach Schedule 8812	67	
68	American opportunity credit from Form 8863, line 8	68	
69	Net premium tax credit. Attach Form 8962	69	
70	Amount paid with request for extension to file	70	
71	Excess social security and tier 1 RRTA tax withheld	71	
72	Credit for federal tax on fuels. Attach Form 4136	72	
73	Credits from Form: **a** ☐ 2439 **b** ■ Reserved **c** ■ Reserved **d** ☐	73	
74	Add lines 64, 65, 66a, and 67 through 73. These are your **total payments** ▶		74

Refund

Direct deposit? See instructions.

75	If line 74 is more than line 63, subtract line 63 from line 74. This is the amount you **overpaid**	75
76a	Amount of line 75 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	76a
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings	
▶ d	Account number	
77	Amount of line 75 you want **applied to your 2015 estimated tax** ▶ 77	

Amount You Owe

78	**Amount you owe.** Subtract line 74 from line 63. For details on how to pay, see instructions ▶	78
79	Estimated tax penalty (see instructions) 79	

Third Party Designee

Do you want to allow another person to discuss this return with the IRS (see instructions)? ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ | Phone no. ▶ | Personal identification number (PIN) ▶

Sign Here

Joint return? See instructions. Keep a copy for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature	Date	Your occupation	Daytime phone number
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

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Modified Adjusted Gross Income under the Affordable Care Act

July 2014

Under the Affordable Care Act, eligibility for income-based Medicaid[1] and subsidized health insurance through the Marketplaces is calculated using a household's Modified Adjusted Gross Income (MAGI). The Affordable Care Act definition of MAGI under the Internal Revenue Code[2] and federal Medicaid regulations[3] is shown below. For most individuals who apply for health coverage under the Affordable Care Act, MAGI is equal to Adjusted Gross Income. This document summarizes relevant federal regulations; it is not personalized tax or legal advice. Consult the Health Insurance Marketplace for your state, your local Medicaid agency, or a legal or tax advisor for assistance in determining your MAGI.

Modified Adjusted Gross Income (MAGI) =

Adjusted Gross Income (AGI)

Line 4 on a Form 1040EZ

Line 21 on a Form 1040A

Line 37 on a Form 1040

Include:

- Wages, salaries, tips, etc.
- Taxable interest
- Taxable amount of pension, annuity or IRA distributions and Social Security benefits[4]
- Business income, farm income, capital gain, other gains (or loss)
- Unemployment compensation
- Ordinary dividends
- Alimony received
- Rental real estate, royalties, partnerships, S corporations, trusts, etc.
- Taxable refunds, credits, or offsets of state and local income taxes
- Other income

Deduct:

- Certain self-employed expenses[5]
- Student loan interest deduction
- IRA deduction (traditional IRAs)
- Moving expenses
- Penalty on early withdrawal of savings
- Health savings account deduction
- Alimony paid
- Domestic production activities deduction
- Certain business expenses of reservists, performing artists, and fee-basis government officials

Note: Check the IRS website for detailed requirements for the income and deduction categories above. Do not include Veterans' disability payments, workers' compensation or child support received. Pre-tax contributions, such as those for child care, commuting, employer-sponsored health insurance, flexible spending accounts and retirement plans such as 401(k) and 403(b), are not included in AGI but are not listed above because they are already subtracted out of W-2 wages and salaries.

+ Add back certain income

- Non-taxable Social Security benefits[4] (Line 20a minus 20b on a Form 1040)
- Tax-exempt interest (Line on 8b on a Form 1040)
- Foreign earned income & housing expenses for Americans living abroad (Form 2555)

− Exclude from income

For Medicaid eligibility

- Scholarships, awards, or fellowship grants used for education purposes and not for living expenses
- Certain American Indian and Alaska Native income derived from distributions, payments, ownership interests, real property usage rights, and student financial assistance
- An amount received as a lump sum is counted as income only in the month received

[1] Medicaid eligibility is generally based on MAGI for parents and childless adults under age 65, children and pregnant women, but not for individuals eligible on the basis of being aged, blind, or disabled.

[2] 26 CFR 1.36B-1(e)(2)

[3] 42 CFR 435.603(e)

[4] "Social Security benefits" includes disability payments (SSDI), but does not include Supplemental Security Income (SSI), which should be excluded.

[5] Deductible part of self-employment tax; SEP, SIMPLE, and qualified plans; health insurance deduction. Note that the IRS states that "if you purchase coverage in the individual Marketplace and claim the premium tax credit on your tax return, the amount of the premium reimbursed by the credit may not also be deductible."

2015 Special Needs Trusts
The National Conference

The Role of MAGI in Special Needs

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U.S. Tax Code

Why is MAGI Important

- Tax Credit for Purchase of Health Care Coverage on Public/Private Exchanges
- Can be Advanced and Refundable
- Amount of Credit depends on MAGI and the Premium for the Exchange Plan

General Schematic

	Gross Income
Less	Above the Line Deductions
	Adjusted Gross Income
Less	Standard or Itemized Deductions
Less	Personal Exemptions
Equals	Taxable Income
Times	Tax Rate
	Gross Tax Liability
Less	Tax Credits
Equals	Net Tax Liability (Tax Refund)

1913 Federal Income Tax Rates

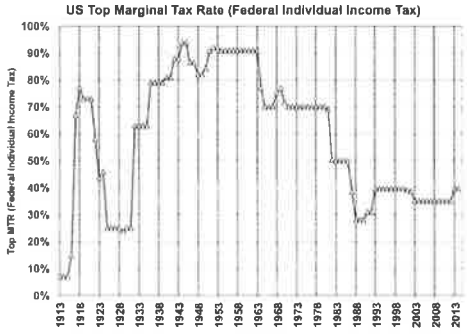
$3,000 to $20,000 in earnings	1% Income Tax
$20,000 to $50,000 in earnings	2% Income Tax
$50,000 to $75,000 in earnings	3% Income Tax
$75,000 to $100,000 in earnings	4% Income Tax
$100,000 to $250,000 in earnings	5% Income Tax
$250,000 to $500,000 in earnings	6% Income Tax
Over $500,000 in earnings	7% Income Tax

1913 – Average Family Income - $500 per year

2015 Federal Income Tax Rates (Single)

$0 to $9,225 in earnings	10% Income Tax
$9,226 to $37,450 in earnings	15% Income Tax
$37,451 to $90,750 in earnings	25% Income Tax
$90,751 to $189,300 in earnings	28% Income Tax
$189,301 to $411,500 in earnings	33% Income Tax
$411,501 to $413,200 in earnings	35% Income Tax
Over $413,201 in earnings	39.6% Income Tax

2014 – Median Household Income - $53,891 per year



Gross Income

- § 61

Inclusion in Adjusted Gross Income

- Wages
- Interest
- Dividends
- State and Local Refunds
- Alimony
- Business Income
- Capital Gains (or Losses)
- Rental Real Estate, Royalties, Partnerships, Trusts
- IRA Distributions & Pensions
- Social Security
- Certain Veterans Benefits

Exclusion From Adjusted Gross Income

- Gifts & Inheritances
- Moving Expense Reimbursements
- Employee Benefits
  - No Additional Cost Services
  - Qualified Employee Discounts
  - De Minimis Fringe Benefits
  - Meals & Lodging

Exclusion From Adjusted Gross Income

- Prizes & Awards
- Damages for Personal Injury
- Life Insurance Proceeds
- Scholarships or Fellowships
- Educational Assistance Programs

Above the Line Deductions

- Moving Expenses
- Qualified Tuition
- Student Loan Interest
- Alimony
- IRA Deduction
- Penalty on Early Withdrawal of Savings
- Health Savings Account Deduction
- Self Employment Tax
- Student Loan Interest
- Tuition and Fees

General Schematic

	Gross Income
Less	Above the Line Deductions
	Adjusted Gross Income
Less	Standard or Itemized Deductions
Less	Personal Exemptions
Equals	Taxable Income
Times	Tax Rate
	Gross Tax Liability
Less	Tax Credits
Equals	Net Tax Liability (Tax Refund)

MAGI Add-Back

- Non-Taxable Social Security Benefits
- Tax-Exempt Interest
- Foreign Earned Income and Housing Expenses

Medicaid Eligibility

- Exclude from Income
  - Scholarships
  - Awards
  - Fellowship Grants
- American Indian and Alaska Native income from –
  - Distributions
  - Payments
  - Ownerships Interests
  - Real Property Usage Rights
  - Student Financial Assistance
- Lump sums received counted as income only in month received

MISCELLANEOUS

- Deduction for Child Care Expenses

PRE-CONFERENCE:

TAX INTENSIVE

Wednesday, October 14, 2015
10:00 A.M. – 11:00 A.M.

Income Under the Tax Rules: Not Everything A Trustee Receives is Taxable Income

Presenters:
Robert B. Fleming
Attorney at Law, Fleming & Curti, PLC
Tucson, AZ
and
Nell Graham Sale
Attorney at Law, Pregenzer, Baysinger, Wideman & Sale
Albuquerque, NM

- Materials
- PowerPoint

Stetson University College of Law presents:
2015 SPECIAL NEEDS TRUSTS
THE NATIONAL CONFERENCE
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The Vinoy Renaissance Resort & Golf Club
St. Petersburg, Florida

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INCOME UNDER THE TAX RULES: NOT EVERYTHING A TRUSTEE RECEIVES IS TAXABLE INCOME

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What is Income?

The Treasury Regulations provide a definition of income for the purposes of trusts.[1] The first line of that definition provides the following language, which you may or may not find very helpful:

> § 1.643(b)-1 Definition of Income
>
> For purposes of subparts A through D, part I, subchapter J, chapter 1 of the Internal Revenue Code, "income," when not preceded by the words "taxable," "distributable net," undistributed net," or "gross," means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable law.

Before we dig into what this means, let's list all of the other kinds of "income" that we can think of that you may come across in your practices, and which trustees may encounter as they administer trusts. Our task today is to familiarize you with all of these types of income so that you can knowledgably advise trustees and/or disabled trust beneficiaries and their families. You will also find that you may need to advise accountants, because many accountants, even CPA's, do not do much trust accounting. And of course you will need to "advise" caseworkers at Medicaid and Social Security offices, who may not be well versed in what is countable income and what is taxable income for eligibility purposes of the beneficiary.

What is gross income? According to Section 61(a) of the Internal Revenue Code ("IRC"), for individuals gross income includes: compensation for services, including fees, commissions, fringe benefits and similar items; gross income derived from business; gains derived from dealings in property; interest; rents; royalties; dividends; alimony and separate maintenance payments; annuities; income from life insurance and endowment contracts;

[1] Treas. Reg. § 1.643(b)-1

pensions; income from discharge of indebtedness; distributive share of partnership gross income; income in respect of a decedent; and income from an interest in an estate or trust.[2] In the instructions to the Form 1040, the Internal Revenue Service ("IRS") helpfully defines Adjusted Gross Income as all income minus adjustments. We learned earlier today about Modified Adjusted Gross Income ("MAGI"), which adds to gross income items that are not usually included in gross income, such as non-taxable Social Security benefits (but not Supplemental Security Income ("SSI") payments), tax-exempt interest and foreign earned income & housing expenses for Americans living abroad. Furthermore, if you are looking at MAGI for Medicaid eligibility for an individual, you can deduct from MAGI scholarships, awards, or fellowship grants used for education purposes and not for living expenses, certain American Indian and Alaska Native income derived from distributions, payments, ownership interests, real property usage rights, and student financial assistance and any amount received as a lump sum is to be counted as income only in the month received. From MAGI, you can "adjust" or deduct certain self-employment expenses, student loan interest, IRA contributions to traditional IRAs, moving expenses, penalties on early withdrawal of savings, health savings account contributions, alimony paid, costs of domestic production activities, and certain business expenses of reservists, performing artists, and fee-basis government officials.[3]

And why do we care about MAGI? Because there is an additional tax assessed under the Affordable Care Act, and it is calculated based on the MAGI of individuals as well as trusts. The Affordable Care Act of 2010 included a provision for a 3.8% Net Investment Income Tax ("NIIT"), also known as the Medicare surtax, to fund Medicare expansion. The tax, which went into effect on January 1, 2013, applies to what the IRS classifies as "certain unearned income,"

[2] IRC § 61(a)
[3] http://laborcenter.berkeley.edu/pdf/2013/MAGI_summary13.pdf

including taxable interest, ordinary dividends, and capital gains distributions from investments, as well as nonqualified annuities, rents, royalties, passive income from business activities, and undistributed investment income from a trust or estate. The Medicare surtax applies to the lesser of net investment income ("NII") or the excess of MAGI above certain thresholds.[4]

Finally, there is another definition of "income" that trustees and beneficiaries of special needs trusts have to deal with all the time. That is the use of the term "income" when determining eligibility for certain government benefits, such as Medicaid and SSI. In the world of Medicaid eligibility, income is anything that "comes in" during a calendar month. A beneficiary's income for a particular month can be affected by a distribution from a trust that is not cash but which has value, and therefore, because it "comes in" to the beneficiary's hands, it is counted as income for that month. With SSI, there is the added component of "in-kind support and maintenance ("ISM"), which may not even be paid to the beneficiary directly but which can reduce the cash stipend of the beneficiary by up to 1/3 of the beneficiary's monthly payment.

Income Taxation of Trusts

The story of what trustees must decipher regarding income begins with an explanation of the income taxation of trusts. In general, the income received by trusts is not substantially different than the income received by individuals. However, once inside the trust, as stated in the quote from the Treasury Regulations earlier, there are three ways that income held by a trust can be described. The three types of income in trusts are: "trust accounting income" as defined in Treas. Reg. §1.643(b)-1; "income" as defined in Treas. Reg. §1.671-2(b); and "distributable net income" as defined in Treas. Regs. §§ 1.652(a)-1 and 1.661(a)-2. Trust accounting income is all of the earnings of the trust which may or may not be distributed. Trust accounting income is

[4] IRC § 1411(a)(2)(A) & B

akin to "gross income" for individuals in that it is the total of everything that is earned by the trust assets, which may include interest, dividends and capital gain.[5] Income is the earnings of the trust which are attributed for income tax purposes to the trust, the beneficiary or the grantor. It can be understood as "taxable income."[6] Distributable net income is the calculation of what has been distributed by the trust during the tax year. Distributable net income is a deduction against the taxable income of the trust. It may represent the value of principal that was distributed by the trust. A distribution of principal that is less than or equal to the accounting income of the trust will "drag out" the equivalent value of income earned.[7] Distributable net income is reported as distributed to the individual taxpayer as income, and that taxpayer must report the distribution as income.

Federal income taxation of trusts depends initially on whether a trust is categorized as a "grantor trust," in which the taxable income is attributed to the "grantor" of the trust, or a "non grantor trust," which is all other trusts. The provisions in the IRC pertaining to taxation of non grantor trusts are found in Chapter J, Sections A through D, and the provisions in the IRC pertaining to grantor trusts are found in IRC §§ 671 to 678. A non grantor trust has its own employer identification numbers ("EIN") and if the trust earns any taxable income or gross income of more than $600, it must file an income tax return each calendar year using Form 1041.

On the Form 1041, a trust may be identified as either a simple trust or a complex trust. A simple trust is one which distributes all of the income in a tax year.[8] A complex trust is every other kind of trust other than a simple trust.[9] A complex trust, for example, could be a

[5] Treas. Reg. § 1.643(b)-1.
[6] Treas. Reg. § 1.671-2(b).
[7] IRC § 651; IRC § 661.
[8] IRC § 651.
[9] IRC § 661.

discretionary trust, where distributions of income and principal are discretionary with the trustee. In a given year, the trustee of a discretionary trust may decide to distribute all of the income to the beneficiary. In that particular tax year, the trust would be a simple trust. However, in the following tax year, the trustee may decide to retain some of the income and reinvest it. In that tax year, the trust would be a complex trust. A qualified disability trust is a complex trust with a disabled beneficiary. Non grantor special needs trusts are generally complex trusts, because they would never be drafted to have a mandatory distribution of income each year. However, if all income were distributed, the special needs trust could be a simple trust for that tax year, and it could also be a qualified disability trust.

Trusts, like individual taxpayers, may take deductions against trust accounting income. The primary deduction and usually the largest deduction is distributable net income ("DNI"). The trust uses the amount of income that has been distributed as a deduction against its own taxable income. Consider the trust as a funnel and you can see that the income that it keeps is the amount that it brings in minus the amount that it sends out. DNI of a trust is calculated by first taking all of the trust accounting income minus the expenses attributed to tax exempt income and a pro rata share of all general expenses deducted by the trustee. The calculation of DNI is made on the second page of Form 1041. For a simple trust, of course, all income would be included in DNI. For a complex trust, the DNI will be just that amount of income that the trustee has distributed during the tax year. The trustee will report the amount of income distributed to the beneficiary on the Schedule K-1. The beneficiary will pay the income tax liability on the income reported on the K-1. The trust will pay the income tax liability on any taxable income that it retains. It needs to be noted that even if the trust does not distribute trust accounting income, but instead distributes an item of principal, to the extent the value of the

principal that was distributed is more than or equal to the trust accounting income, the trust will report a distribution of all of its income as DNI.[10] The beneficiary of the item of principal will receive a Schedule K-1 from the trustee reporting that the beneficiary received income, even if the beneficiary did not receive any cash. This is how DNI works.

Special Needs Trusts are always going to be complex trusts, unless they are grantor trusts. We will address grantor trusts in a later session. A trustee of a Special Needs Trusts should never be given the mandate to distribute all income to the beneficiary. However, as we saw above, because of the DNI rules, it is quite possible for a trustee of a Special Needs Trust to report on a Schedule K-1 issued to a disabled beneficiary that all of the income was distributed, even though the beneficiary did not receive any cash. This can be confusing to caseworkers whose jobs consist of making sure that people with disabilities who are receiving means-based government benefits are still eligible. In an annual redetermination, it is very easy for a caseworker to plug in the Social Security number of a recipient and find that they filed an income tax return reporting having received a distribution of income from a trust. Generally, people receiving government disability benefits do not have taxable income. But when they do, and it is sufficient to be reported on their Form 1040, this can raise some eyebrows. Understanding how DNI works is essential to representing beneficiaries of Special Needs Trusts.

Trusts, like individuals, have exemptions against taxable income. A simple trust, one which distributes all of its income, may take an exemption of $300 per year.[11] Therefore, the trust may report that it distributed all but $300 of its income, and reduce its taxable income to zero with the exemption. This saves the taxpayer $300 in reportable taxable income. Complex

[10] IRC § 652.
[11] IRC § 642(b).

trusts have an exemption of $100.[12] Qualified disability trusts may use the amount of the personal exemption of the beneficiary as the exemption amount of the trust.[13] The balance of the trust's income reportable after all deductions and exemptions is its taxable income.

Trusts have the same tax rates as individuals. However, the tax brackets of trusts are highly compressed. For example, in 2015, a trust will pay the highest rate of 39.6% on taxable income over $12,300.[14] Consequently, a trustee of a complex trust will want to carefully consider the income tax consequences of retaining income in the trust, because more dollars will be paid in income tax by the trust than by an individual taxpayer on the same amount of income. Furthermore, as of January 1, 2013, the Health Care and Education Reconciliation Act of 2010 imposed a Medicare surtax of 3.8% on taxpayers who are in the highest federal income tax bracket, which in 2015 is 39.6%.[15] Individual taxpayers who have MAGI over $200,000 will pay the Medicare surtax. Estates and trusts, other than charitable trusts, are subject to this surtax on the lesser of undistributed net investment income or the excess of AGI in excess of the highest tax bracket.[16] Therefore, trusts that retain income in excess of $12,300 in 2015 will pay

---

[12] IRC § 642(b)(2)(A).
[13] IRC § 642(b)(C)(i).

[14] ***2015:***

If Taxable Income Is:	***The Tax Is:***
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300
	+ 3.8% Medicare Surtax

[15] P.L. 111-152; IRC § 1411(a)(2)(A) & B
[16] *Id.*

federal income tax on the amount over $12,300 at 39.6%, plus pay a surtax of 3.8% on the MAGI amount, making the effective federal rate 43. 4%. Additionally, in 2015, as a result of the American Taxpayer Relief Act of 2013 ("ATRA"), non grantor trusts have even further income tax burdens. The ATRA imposes a higher capital gain rate of 20% on taxpayers in the 39.6% bracket, which for a trust occurs when taxable income exceeds $12,300.[17] For individual taxpayers, the income threshold for the 20% capital gain rate is $413,201 for single filers in 2015.[18]

As stated earlier, one of the three types of income defined in the Internal Revenue Code is "taxable income." The definition of taxable income for trust purposes is that amount that is attributed for tax purposes to a particular individual taxpayer.[19] That taxpayer can either be the trust, the beneficiary of the trust or it can be the grantor. To whom the taxable income is attributed is determined by the terms of the trust agreement. If a trust is a non grantor trust, the taxable income retained by the trust will be attributed to the trust, and the taxable income distributed will be attributed to the beneficiary. However, if a trust is a grantor trust, whether the trust is a simple trust or a complex trust, no matter who actually receives the earnings of the trust, the grantor will report on his or her Form 1040 the taxable income earned by the trust. As drafters of trust agreements, therefore, it is very important that we understand what provisions of trust agreements will govern to whom the income for tax purposes will be attributed.

Allocations of Principal or Income

[17] Rev. Proc. 2013-15, § 2.01, Table 5.
[18] IRC § 1(h)(1) and § 1(i)(3) as amended by ATRA §§ 101 and 102.
[19] Treas. Reg. § 1.671-2(b).

In the IRS definition of "income" for trusts, recall that "income" means "the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable law."[20] By that definition, this is what would be described by accountants as "fiduciary accounting income" (which is the same as "trust accounting income"). The terms of the trust document will be the first place to look to see what guidance it may give as to what is to be counted by the trust as its income and what is not. For example, if the trust is a simple trust, it will state that all income earned by the trust is to be distributed every year to the beneficiary. So the trustee must determine what income of the trust is to be distributed. This sounds simple enough, until you get into the accounting issues faced by a trustee.

To begin with, what constitutes income received by the trustee? Many trusts are silent on this issue, and when that is the case, the trustee has to look to state law to figure out what to do. Most states (all but Georgia, Illinois and Louisiana) have passed the Uniform Principal and Income Act ("UPIA"). The UPIA in general states that the terms of the trust will prevail even if they differ from the terms of the statute. If the trust is silent, however, the UPIA expressly authorizes the trustee to deviate from the UPIA rules if it uses certain guidelines. The New Mexico UPIA statute makes that clear in Section 46-3A-104[21]

The UPIA default rules treat the following trust receipts as receipt (or return) of principal:

(a) Property "other than money"

(b) Money received in exchange for a trust's interest in an entity (whether in one payment of a series of payments

(c) Money received from an entity as part of a liquidation or partial liquidation

[20] Treas. Reg. § 1.643(b)-1
[21] 46-3A-104(a) NMSA

(d) Money from a REIT or regulated investment company if it is treated as a capital gain distribution for federal income tax purposes

(e) Returns from the sale, exchange, liquidation or change in form of a principal asset.

Everything else is income.

Remember, a trust is a funnel, and trustees only hold assets for the benefit of someone else. What is a trustee to do when the trust has sold an appreciated asset during the calendar year? Is the capital gain realized to be distributed as income to the beneficiary or not? Should the beneficiary pay the capital gain tax or should the trust hold the capital gain and pay the tax? Capital gain is generally not included in DNI, because it is commonly attributed to the principal. However, if the terms of the trust provide enough flexibility for the trustee, it might be advantageous to distribute capital gain, because of a higher tax rate assessed on capital gain if the trust retains more than $12,300 in income. Furthermore, if the trust has expenses such as the fees of the trustee or administrative expenses such as investment fees, should the trustee allocate those deductions against income or against the principal of the trust? A trustee who is given broad administrative discretion in the terms of the trust document may decide to retain the capital gain in the trust and have the trust pay the tax, but distribute all other earnings of the trust to the beneficiary. The trustee may decide to allocate all expenses of the trust to the capital gain and not reduce the income distributed to the beneficiary. But if a trust does not provide that kind of discretion, either because is silent, or because it provides that the trustee must follow the UPIA regarding allocations and distributions, then here is what the UPIA adopted by New Mexico would say on this issue.

> …a trustee shall consider all factors relevant to the trust and its beneficiaries, including the following factors to the extent they are relevant:

(1) the nature, purpose and expected duration of the trust;
(2) the intent of the settlor;
(3) the identity and circumstance of the beneficiaries;
(4) the needs for liquidity, regularity of income, and preservation and appreciation of capital;
(5) the assets held in the trust; the extent to which they consist of financial assets, interest in closely held enterprises, tangible and intangible personal property or real property; the extent to which an asset is used by a beneficiary and whether an asset was purchased by the trustee or received from the settlor;
(6) the net amount allocated to income under the other sections of the Uniform Principal and Income Act and the increase or decrease in the value of the principal assets, which the trustee may estimate as to assets for which market values are not readily available;
(7) whether and to what extent the terms of the trust give the trustee the power to invade principal or accumulate income of prohibit the trustee from invading principal or accumulating income, and the extent to which the trustee has exercised a power from time to time to invade principal or accumulate income;
(8) the actual and anticipated effect of economic conditions on principal and income and effects of inflation and deflation; and
(9) the anticipated tax consequences of an adjustment.

§ 46-3A-104 NMSA

It is evident that in general, a trustee relying on the UPIA to make adjustments would still have a great deal of discretion, guided as always by the basic fiduciary duty of loyalty to the best interests of the beneficiary. It should be noted that a trustee has no discretion to adjust if the trust terms require that an annuity amount be distributed, or if the trust is a total return trust.

Conclusion

In conclusion, determining what is income and what is not income given the particular circumstances of a trust is critical to the proper administration of a trust. Depending on the terms of the trust document, decisions about the taxation of a trust can make a significant difference in the amount of money paid in tax by the trust. It can also affect the status of the beneficiary who might be eligible for certain benefits upon which he or she is dependent.

INCOME UNDER THE TAX RULES: NOT EVERYTHING A TRUSTEE RECEIVES IS TAXABLE INCOME

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What is Income?

- Definition of Income for Trusts:
  - Treas. Reg. § 1.643(b) -1
- Definition of Income for individuals
  - IRC § 61(a)
- MAGI
- Distributions from other trusts or estates
- Distributions from IRAs
- Means based programs

Income Taxation of Trusts

- Gross earnings of more than $600 per year or any taxable income
- Depends on explicit terms of the trust
- Revocable or irrevocable trust
- Who is the taxpayer?
  - Grantor
  - Trust
  - Beneficiary

Types of Trusts for Income Tax Purposes

- Form 1041 is the tax return for Trusts
- Requires an Employer Identification Number ("EIN")
- Relevant Trust types listed on Form 1041 include:
  - Simple Trust
  - Complex Trust
  - Qualified Disability Trust
  - Grantor type trust

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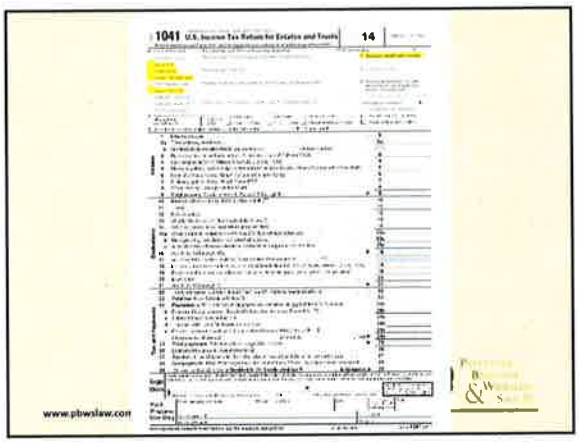

Simple Trust

- All income required to be distributed to the beneficiary
- Examples:
  - Marital Trust
  - Trust holding subchapter S stock

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Complex Trust

- Distribution of income discretionary with Trustee
- Examples:
  - Special needs trust
  - Trust for minor child

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Trust Accounting Income

- "The amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable law."
  - Treas. Reg. § 1.643(b) -1

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Distributable Net Income

- "DNI"
- Income distributed to the beneficiary in a given year
- Deduction against taxable income of trust
- Will be triggered by distributions of principal
- Will generate Schedule K-1
- May cause beneficiary to have to report taxable income

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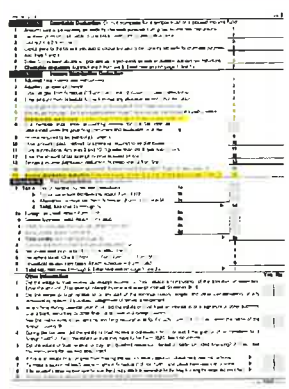

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Tax Rates for Trusts 2015

- Income tax rates for estates and trusts in 2015:

If Taxable Income Is:	The Tax Is:
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300
	+ 3.8% Medicare Surtax

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Medicare Surtax

- Net Investment Income Tax ("NIIT")
- Effective as of January, 2013
- Result of Affordable Care Act
- Assessed on taxpayers in 39.6% bracket
- Trusts with MAGI over $12,500 in 2015
- Individuals with MAGI over $200,000

Qualified Disability Trust

- Distribution of income discretionary with Trustee
- Must be for a disabled beneficiary
- Described in IRC § 642(b)(2)(C)(i) and (ii)
- Complex trust with higher exemption
- Example:
  - Testamentary Special Needs Trust

Grantor Trust or Non-Grantor Trust?

- If the Grantor retains sufficient control in the trust assets
- Grantor is taxed rather than trust or beneficiary no matter if the trust retains income or distributes DNI to the beneficiary
- Grantor trust rules in IRC §§ 671-678

Allocation of Principal and Income

- Uniform Principal and Income Act (UPIA")
- What is not income?
  - Property other than money
  - Money received in exchange for property by trust
  - Money received for a liquidation of asset by trust
  - Money received from a REIT
  - Returns for sale, exchange, liquidation or change of form of a principal asset

Treatment of Capital Gain

- Depends on the terms of the trust
- May depend on state law
- Advantages and disadvantages of including capital gain in DNI
- Total Return Trusts

Conclusion

Determining what is income and what is not income given the particular circumstances of a trust is critical to the proper administration of a trust. Depending on the terms of the trust document, decisions about taxation of a trust can make a significant difference in the amount of money paid in tax by the trust. It can also affect the eligibility of a beneficiary who is receiving public benefits.

Contact Information

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PRE-CONFERENCE:

TAX INTENSIVE

Wednesday, October 14, 2015
11:15 A.M. – 12:15 P.M.

The Interplay of Income, Estate and Gift Tax

Presenters:
Robert B. Fleming
Attorney at Law, Fleming & Curti, PLC
Tucson, AZ
and
Nell Graham Sale
Attorney at Law, Pregenzer, Baysinger, Wideman & Sale
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THE INTERPLAY OF INCOME, ESTATE AND GIFT TAX

I. Income Tax

A. Individual Income Tax. When making decisions for clients regarding Medicaid and special needs planning, one must keep in mind that there may be individual income tax consequences to those decisions.

1. Qualified Income Trusts. Medicaid rules differ from state to state, but one way or another, the monthly income of a Medicaid recipient is taken into account. If the income is determined to be too much for eligibility, the states have invented methods to allow eligibility while reducing countable income. Now federal law provides for these "qualified income trusts."[1] When a qualified income trust is funded, it is common practice for all of the income of the Medicaid recipient to be directed into the trust. Once a month, the Trustee issues checks. In some states, these checks are for a precalculated amount of income that represents the maximum allowable amount to be deemed to be available to the Medicaid recipient. In other states, this amount is the entire corpus of the trust. This amount is used to pay for the cost of care at the nursing home, the personal needs allowance and any allowable trustee fees, among other things. Either the balance of the income remains in the trust or the entire amount is spent. At the death of the Medicaid recipient, the balance in the trust, if any, is paid to Medicaid to reimburse Medicaid for any monies that have been expended by Medicaid for the care of the recipient.

[1] 42 USC § 1396p d(4)(B)

If the Medicaid recipient has sufficient income, he or she may have an income tax liability on the income diverted to the trust. However, even though the income that is being directed into the trust may be taxable income, there is no provision in the qualified income trust arrangement for any money to be set aside to pay an income tax liability. For single Medicaid recipients, even after taking a medical deduction for the funds paid to the nursing home, if there is an income tax liability, the only solution is for a family member to contribute the funds that may be required to pay the income tax liability.

For a married Medicaid recipient, one solution to this problem is to have the income of the Medicaid recipient be deposited first into a joint account. The community spouse can then issue a check from that account each month to the qualified income trust. On the joint individual income tax return, the community spouse can report the joint income, and take a medical deduction for the amount used from the joint income of the couple for the cost of care of the Medicaid recipient, thus reducing the taxable income of both taxpayers. If there is any income tax liability, it can be paid from the income of the community spouse.

2. Timing of Liquidation of Retirement Plans. If a retirement plan such as an IRA has to be liquidated in order for the Medicaid recipient to be eligible, it is important to consider the timing of that liquidation so as to minimize the income tax liability on that liquidation. What is advisable is to have the liquidation occur after the Medicaid applicant has entered a skilled nursing facility but before eligibility for Medicaid. The cost of the skilled nursing facility will be an income tax deduction for medical care which can be taken against the taxable income realized by the liquidation of the IRA.

Additionally, one must take into account the income tax consequences of annuitizing an IRA, which is a safe harbor under the Deficit Reduction Act of 2005.[2] All distributions from IRA's are ordinary income. Therefore, when an IRA is annuitized in order to obtain Medicaid eligibility, one must take into account that each regular payment from an IRA to the spouse of a Medicaid recipient will be included in his or her taxable income as ordinary income.

B. Fiduciary Income Tax. Trusts are commonly used for Medicaid planning. It is important to know about the income taxation of trusts so that one does not overlook planning opportunities that may be available.

1. Income Only Trusts. If a trust has been established for the benefit of the Medicaid recipient that by its terms may only distribute income to or for the benefit of the Medicaid recipient, the trust itself will not owe income tax, because all of its income will be distributed currently. This is called a Simple Trust. (The trust may owe capital gains tax if it has realized a gain on the sale of an appreciated asset, and by its terms is not required to distribute that gain as income to the beneficiary.) The trust will need to file an income tax return, which is filed on Form 1041, U.S. Income Tax Return for Estates and Trusts. The trustee reports how much income was earned by the trust and that the trust has distributed all of its income, and along with the return, the trustee files a Schedule K-1 that reports the amount of income that was distributed during the previous tax year to the beneficiary of the trust. Federal fiduciary income tax returns are due on April 15 of the year following the tax year. All trusts use the calendar year as their tax year.

2. Discretionary Trusts. Special Needs Trusts as well as traditional support trusts will result in many people being beneficiaries of discretionary trusts. Because there is no

[2] 42 USC §§ 5001 *et. seq.*

requirement that income be distributed currently, these are called Complex Trusts. As with Simple Trusts, the Trustee must file an income tax return that reports the amount of income, if any, that was earned and distributed during the tax year. This is called distributable net income ("DNI") and it can be one of the most confusing concepts in fiduciary accounting. In addition, if the trustee distributes principal, but the trust earned income during the tax year, the value of the principal, up to the amount of the accounting income of the trust for that year, will be considered to be a distribution of income. A simple way to explain this is to state that any principal distribution "drags out" income up to the value of the principal distributed. For example, if the trustee purchases an elephant for the beneficiary, which is worth $20,000, and the trust earned $18,000 in income in the tax year, the trustee would report that it distributed $18,000 in distributable net income to the beneficiary, and the trust would have no income to report that it retained. For that tax year, the trust would be a simple trust. If the earned income of the trust was higher than $20,000, and the trustee made no other distributions during the tax year, the trust would report that it distributed $20,000 income to the beneficiary and retained the balance of the income over $20,000, minus a $100 exemption that is available to complex trusts. The trust would owe income tax on that balance, and would also file a Schedule K-1 reporting a $20,000 distribution of income to the beneficiary. The beneficiary, who received an elephant, would have to file an income tax return reporting the $20,000 distribution as taxable income.

Trusts pay income tax at the same rates as individuals. However, the brackets of trusts are very compressed. For 2015, the projected rates and brackets are as follows:

2015: If Taxable Income Is:	***The Tax Is:***
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900

Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over + 3.8% Medicare Surtax

As you can see, a trust that retains $20,000 in earned income will pay $6,514 in federal fiduciary income tax at the 39.6% rate plus the Medicare surtax, after taking the $100 exemption allowed. In comparison, a single individual reporting $20,000 of taxable income will pay tax at the maximum 15% rate, which will be further reduced by the individual exemption of $4,000 in 2015. The tax bill that results from the distribution of the elephant to the individual beneficiary will be 0. All the more reason for the trustee to purchase an elephant for the beneficiary! For an individual to pay income tax at the highest rate of 39.6%, the taxable income must be higher than $413,201.

3. Special Needs Trusts. Special Needs Trusts are complex trusts, because the trustee must use its discretion before distributing income or principal. Being a complex trust, any time that the trustee distributes principal, the value of the principal distributed "drags out" the value of any earned income in the trust and there is a distribution of income to the beneficiary. This seems anomalous, when we know that beneficiaries of special needs trusts are usually receiving means based benefits, such as Supplemental Security Income, and are not allowed to receive income. One must remember that the definition of income for Social Security and Medicaid purposes is different than the definition of taxable income. Using the example of the distribution of an elephant, which is arguably not a countable resource as a pet or household item, it would not affect the income limitations of the beneficiary. However, because it "drags out" income from the trust, there is taxable income reported to the Internal Revenue Service for the beneficiary. The Trustee of a special needs trust will commonly arrange for the preparation

of an income tax return for the beneficiary, pay the expense of the preparation, and pay any income tax liability of the beneficiary.

If a special needs trust retains income, the Internal Revenue Code ("IRC") provides an exception for some special needs trust beneficiaries.[3] It was introduced in the Victims of Terrorism Tax Relief Act of January, 2002. It provides for a higher exemption if the trust is what is defined as a Qualified Disability Trust ("QDT"), that is, one that is established solely for the benefit of an individual under 65 who is disabled. A trust is a QDT even if a remainder beneficiary is not disabled. A special needs trust for a person over age 65 that was funded after age 65 would not qualify as a QDT. For a trust that meets the definition of a QDT, the exemption that is allowed for the trust is the allowable personal exemption for the individual beneficiary. In 2015, the personal exemption is $4,000. Therefore, if a QDT retains $5,000 of earned income, after the exemption amount, it would report $1,000 taxable income, and pay $150 income tax. A complex trust that is not a QDT would have only a $100 exemption, and thus would report $4,900 taxable income and pay $975 in tax.

4. Grantor Trusts. In our practices, we usually associate the term "Grantor" with the person who creates a trust. We understand that this term can be substituted with the terms "Trustor" or "Settlor." However in the IRC, the term "grantor" has a specific meaning that is somewhat broader than what we are accustomed to. In Treasury Regulation Section 1.671-2(e)(1), the term "grantor" for the purposes of the grantor trust rules can be a person who creates a trust (a meaning with which we are comfortable) or a person who makes a gratuitous transfer to a trust, directly or indirectly.[4] Therefore, a person who creates a trust and has the title of Grantor according to our common meaning of the term might fit one of the

[3] IRC § 642(b)(2)(C)(i), (ii)
[4] Treas. Reg § 1.671-2€(1)

definitions of grantor under the IRC. However, there can be additional grantors under the IRC who are persons who gratuitously transfer anything into that trust. The additional grantors can become such by either a direct transfer or an indirect transfer. What would that look like? Let's say that a parent created an irrevocable trust for a child. The parent is of course the Grantor or creator of the trust. Somewhat later, a grandparent decides to make a gift to the trust for the benefit of the child. The grandparent may also be a grantor, even though the grandparent did not create the trust.

Under the IRC, once a person has become a possible grantor by creating the trust or donating to the trust, if the terms of the trust establish sufficient control in such person, then the person is deemed to be the owner of the trust property, not the trust. Thus the grandparent who transferred property in the above example could be treated as the continuing owner of the transferred property, depending on the terms of the trust. For income tax purposes, the grantor is taxed on the income earned by the property in the trust of which the grantor is deemed to be the owner. The trust is ignored for income tax purposes and the income is treated as if it were distributed to the grantor, even if it is not actually distributed to the grantor. In the example of the transfer from the grandparent, if the grandparent is a grantor, the income earned by the assets in the trust that were contributed by the grandparent is attributed to the grandparent for income tax purposes. Therefore, if a drafter wants income to be attributed to the person who establishes a trust, or to persons who contribute assets to the trust but who did not create the trust, then the drafter needs to make sure that the terms of the trust agreement provide sufficient control in the grantor to establish a grantor trust.

The Grantor Trust Rules are found at Sections 671 to 678 in the Code and in the accompanying Treasury Regulations at Sections 1.671-1 to 1.678-(a)1 *et.seq*..

5. Estates. An estate can also earn income. If an estate earns more than $600 of gross income during any fiscal year, it will need to file an income tax return. Estates generally will distribute all income at the end of administration, but may or may not distribute income during administration. Estates have the same income tax rates as trusts. However, estates have great flexibility to determine fiscal years. Depending on the circumstances, the Personal Representative may determine that the appropriate fiscal year for an estate may be a short year for the first year, and/or a short year for the final year. The only parameters guiding the choice of fiscal year are that it cannot be longer than the period from the date of death until the end of the month in the next year that immediately precedes the month of death. For example, if a decedent died on November 15, 2013, the maximum length fiscal year would be from November 15, 2013 until October 31, 2014. It is not uncommon for the Personal Representative to elect a short first fiscal year, in order to make maximum use of deductions that the estate can take that are not available to the beneficiaries, such as the expenses of administration.

II. Capital Gains Tax

A. Basis of Property Transferred by Sale. Property often must be liquidated as part of the spenddown to prepare for Medicaid eligibility or a trustee many need to sell property. The practitioner must be aware that a sale of appreciated property will realize capital gain. If the property has been held for more than 12 months, it will be subject to long term capital gain tax. The capital gain is calculated by subtracting the adjusted basis from the adjusted sale price. For real property, the adjusted basis is the amount that was paid for the property when it was purchased by the taxpayer (cost basis), reduced by any depreciation taken during the time that the property was held, and increased by the cost of any capital improvements made to the property. The adjusted sale price is the price paid for the property by the buyer reduced by any

costs of sale that were paid by the taxpayer. For sales of long-term capital gain property in 2015, if the seller is in the 10% or 15% income tax bracket, the capital gains tax rate is 0%. If the seller is in the 25% to 35% income tax bracket, the capital gains tax rate is 15%. If the seller is in the 39.6% income tax bracket, the maximum capital gains rate is 20%. The rates are the same for individuals as well as trusts.

B. Basis of Property Transferred by Gift At Death. When an appreciated asset transfers as a result of the death of the owner, the basis steps up to the fair market value as of date of death.[5] Therefore, anyone who inherits appreciated property will also receive a new basis in the property. In community property states, the basis of the entire property will step up if community property is inherited by a surviving spouse.[6]

C. Basis of Property Transferred by Gift During Lifetime. A spend down plan may include making transfers of appreciated property to another person. When a person makes a gift of appreciated property to another person, the basis of the property transfers with the property. Therefore, whatever was the adjusted basis of the transferor becomes the carryover basis of the transferee. For example, father transfers a rental house to daughter. The value of the house when father bought the property was $50,000. While he owned the property, he took depreciation in a total amount of $10,000. He added an addition on the house for $5,000. Therefore, his adjusted basis in the property is

$ 50,000	cost of purchase
- 10,000	depreciation
+ 5,000	capital improvements
$ 45,000	adjusted basis

[5] IRC § 1014(b)
[6] IRC § 1014(b)(6)

If daughter holds the property, she may continue depreciation, but she must use her father's basis. When daughter sells the property, she will realize capital gain and pay tax on the difference between her adjusted sale price and her adjusted basis. If she sells the property for $100,000, with costs of sale of $5,000, and having taken $5,000 in depreciation, her gain will be $45,000.

$100,000	sale price
- 5,000	cost of sale
$ 95,000	adjusted sale price

$ 45,000	carryover basis
- 5,000	depreciation
$ 40,000	adjusted basis

$ 95,000	adjusted sale price
- 40,000	adjusted basis
$ 45,000	taxable gain

What if father transfers real property to himself and daughter as joint tenants with the right of survivorship? The Internal Revenue Service and Medicaid consider this to be a completed gift from father to daughter of one-half of the property, because once the deed is executed and delivered to daughter, father cannot sell the property without her permission. Daughter's carryover basis in her one-half of the property is one-half of father's basis. If father dies, his one-half interest will pass to daughter, and she will obtain a stepped-up basis for father's one-half. If the property value is $100,000 at the time of the gift and at father's death, and father's basis was $45,000 at the time of the gift, and there were no subsequent adjustments to basis during his lifetime, daughter's basis at her father's death is $72,500, that is, $50,000 (father's new basis) plus $22,500 (daughter's basis in one-half of property).

D. Inheriting a Life Estate. Dad dies, leaving his home to his daughter. However, he had a surviving spouse, and the law of his state provides that the surviving spouse, who is daughter's stepmother, receives a life estate in the home, and daughter obtains only a remainder interest. At the death of stepmother, what is the value of daughter's basis in the house?

The section of the IRC that applies is Section 1001(e)(1), which states that in determining the gain or loss from the sale or other disposition of a term interest which is obtained as a result of another's death, the adjusted basis of that term interest shall be disregarded. In plain English, this means that although the basis of a term interest can be determined upon receipt using actuarial tables, if it is sold or if it passes as a result of the life tenant's death, the basis is zero. The regulations pertaining to this IRC section (Treas. Reg. 1-1001-1(f)(4)) refer to another place in the Regulations for examples, Treas. Reg. 1.1014-5(c). Looking at these examples, except for one exception, we find that a disposition of a term interest that is acquired as a result of a gift at death or during lifetime, results in a basis of zero. Thus, the result for our example is that daughter's basis is the value of her remainder interest in the property at the time of her father's death.

There is an exception to calculating gain or loss with a zero basis for a term interest acquired by death or gift. If the owner of the life interest and the owner of the remainder interest later dispose of the entire property to a third party, then the basis of the term interest does have a value of more than zero.[7] But the value of the basis is calculated not as of the time of receipt, but as of the time of the disposition, because the age of the life tenant has increased. This is called the Shifting Basis Rule, and can be found in the Regulations at Sections 1-1014-5(a) and

[7] See IRC § 1001(e)(3)

1-1015-1(b). What we learn here is that when one receives a term interest either from a decedent (Section 1014) or by gift during lifetime (Section 1015), the value of that interest is calculated using actuarial factors based on the life tenant's age.

Therefore, when our stepmother obtained her life interest, the basis of her life interest was a percentage of the total value, calculated using factors to determine the present interest based on her age at the time of dad's death. The value of the daughter's remainder interest, and thus her basis, is calculated by subtracting the value of stepmother's life interest from the total value. But as stepmother aged, the value of her basis shifted at time passed. Once again, if stepmother disposed of her interest during her lifetime to a third party, or if she died without disposing of her life interest, the basis is calculated as zero. But if stepmother and daughter decided to sell their combined interests, then stepmother could use her basis to calculate gain or loss, and she would determine her basis using the factor for her age at the time of the sale multiplied against the value of the property when she acquired her interest. Thus the value of the basis in a term interest "shifts" as the life tenant ages, and the value of the basis of the owner of the remainder interest is increased.[8]

E. Principal Residence Exclusion from Capital Gain. Section 121 of the IRC states that an individual taxpayer can exclude from income up to $250,000 of gain from the sale of a home owned and used by the taxpayer as a principal residence for at least 2 of the 5 years before the sale. The full exclusion does not apply if, within the 2-year period ending on the sale date, the exclusion was applied to another home sale by the taxpayer.

A married couple filing jointly for the year of the sale may exclude up to $500,000 of home-sale gain if (1) either spouse owned the home for at least 2 of the 5 years before the sale,

[8] See examples (3) and (4) in Treas. Reg. 1-1014-5(c)

(2) both spouses used the home as a principal residence for at least 2 of the 5 years before the sale, and (3) neither spouse is ineligible for the full exclusion because of the once-every-2-year limit.

III. Federal Gift Tax

The IRC imposes a tax on certain gratuitous transfers, meaning transfers during lifetime for which the donor receives nothing in return.[9] The gift tax is an excise tax assessed on the net value of the gift on the date of the gift. Not all gifts are taxable. Gifts which are not taxable include: annual gifts of a present interest valued at no more than $14,000; gifts to spouses who are United States citizens; gifts to charities; tuition paid for someone else if paid directly to the educational institution; medical expenses paid directly to the provider; and, gifts to political organizations. For a gift tax to be imposed, a transfer must be a completed gift, that is, out of the control of the transferor. The rate for gift tax in 2015 is 40%. When a lifetime transfer of appreciated property is made, the basis of the property transfers with the property.[10]

A. Direct Lifetime Transfers of Gifts. A gift of $14,000 or less of a present interest to a donee in a calendar year is not taxable or required to be reported. A person can make a series of non-taxable gifts to any number of individuals in the same calendar year. A married couple can make a non-taxable gift of up to $28,000 to an individual. A married couple can make a gift to another married couple, such as their child and his or her spouse, which can total up to $56,000 without the gift being taxable or reportable.

[9] See IRC §§ 2501-2524
[10] IRC § 1015(a)

When a person makes a taxable gift, however, the IRC requires that a gift tax return be filed using Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return. Unless the total cumulative taxable gifts made by a donor exceed $5,430,000 in 2015, no gift tax must be paid even though filing a return is required. Therefore, a person can give up to $5,444,000 ($5,430,000 + $14,000) to another person in one year and still not have to pay gift tax. Gift tax returns are due by April 15 of the year following the year in which the gift was made. Gift tax is payable by the donor.

B. Transfers of Gifts to Trusts.

1. Gifts of Future Interests. If a gift has a condition on it, or if it cannot be spent currently by the donee of the gift, it is a gift of a future interest rather than a present interest. The $14,000 annual exclusion for non-taxable gifts only applies to gifts of a present interest, that is, a gift that has no conditions and that can be used immediately by the donee. Gifts to irrevocable trusts are usually gifts of a future interest, that is, the gift will not be immediately distributable to the beneficiary but will be distributed at a future date according to the terms of the trust. For example, a transfer to a trust for the benefit of a minor is a gift of a future interest, because the minor will not have a power to demand distributions until attaining a certain age. Transfers to trusts in which the trustee has discretionary power over all distributions will always be transfers of a future interest. Therefore, transfers in any amount, even less than $14,000, to discretionary trusts, are taxable gifts.

2. Crummey Powers. In 1968, a couple named Mr. and Mrs. Crummey challenged the IRS on this issue of transfers to trusts being future interests.[11] Mr. and Mrs. Crummey had made transfers to an irrevocable trust for their children, two of whom were

[11] *Crummey v. Commissioner*, 397 F. 2d 82 (9th Circuit, 1968).

minors. The trust was governed by California law. California law at the time provided that a beneficiary of a trust had until the end of the calendar year of the year of the gift to withdraw that transfer, and that after the end of the calendar year, the gift became part of the trust. The IRS took the position that the transfers to the trust were gifts of future interests. Mr. and Mrs. Crummey argued that for the period of time that the child had the right to withdraw the gift, it was a gift of a present interest. Since this period began at the time of the transfer and lasted until the end of the year, then at the time of the gift, it was a present interest. The court agreed with the Crummeys. As a result of that case, when a transfer to an irrevocable trust is made, the trustee can be directed to notify the beneficiaries of the trust that they have a certain limited period of time in which they have the right to withdraw the amount transferred, or a pro rata portion of it. This is now called a Crummey notice. The power conferred to the beneficiaries is called a Crummey power. If the beneficiary does not exercise the Crummey power, then the gift remains in the trust and becomes subject to the discretion or other powers of the trustee.

A subsequent case gave these withdrawal powers to persons other than the present beneficiary of the trust.[12] Ms. Cristofani gave the power to withdraw contributions to her two children and also to five grandchildren, and the grandchildren were only remainder beneficiaries of the trust. The Tax Court agreed that the gifts to the trust were not taxable.

3. Transfers to Special Needs Trusts. Special needs trusts are commonly used to protect assets that either belonged to a disabled recipient or that are given to a trust by someone other than the recipient to provide for his or her special needs.

a. Transfers to d(4)(A) Special Needs Trusts. A d(4)(A) special needs trust is funded with assets that belong to the beneficiary, and thus is considered a grantor

[12] *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991)

trust. These trusts are also called "payback trusts," because at the death of the beneficiary, Medicaid is entitled to be reimbursed from the remaining assets in the trust up to the amount spent by Medicaid for his or her care during the lifetime of the beneficiary. Because the transfer into the trust is of the beneficiary's own assets, and the beneficial interest in the trust is retained by the beneficiary, the trust is a grantor trust and there is not a completed gift to the trust that occurs. Therefore, there are not gift tax considerations for d(4)(A) trusts.

b. Transfers to Third Party Settled Trusts. Transfers by third parties to special needs trusts are gifts of a future interest, because the trustee is prohibited from distributing income or principal except for the beneficiary's special needs. Furthermore, because the beneficiary has severe restrictions on the amount of income that he or she can receive during any month, as well as restrictions on the amount of resources that can be owned by the beneficiary, the beneficiary cannot have a present right to demand a withdrawal of any asset of the trust. Therefore, a Crummey power cannot be given to the beneficiary of a special needs trust. Therefore, any transfers of any amount to a special needs trust will be a gift of a future interest, which is a taxable gift that must be reported on a gift tax return.

One way to overcome this problem is to name other members of the family as additional beneficiaries of the trust for Crummey power purposes only. A special needs trust must have only one beneficiary. Therefore, the trust must be drafted so that it excludes the disabled beneficiary from having a Crummey power but lists other beneficiaries who are available to withdraw transfers to the trust. Furthermore, the trust could provide that while all of the named beneficiaries may receive discretionary distributions as long as the disabled beneficiary is not eligible for or receiving public benefits, when the disabled beneficiary is eligible for or receiving public benefits, he or she is to be the sole beneficiary of the trust. Alternatively, the trust

document could establish separate subtrusts for each of the beneficiaries, and direct the trustee to fund the subtrust for the disabled beneficiary with most of the assets of the trust. After the period for Crummey powers has elapsed, the subtrust for the disabled beneficiary would of course be a special needs trust. Using either of these methods would result in Crummey powers being available for transfers to the trust, and thus the transfers would be gifts of present interests.

In 2015, the gift tax exemption is unified with the federal estate tax exemption. This means that if one does make a taxable gift, even though there may be no gift tax to be paid, one has used up some of the exemption. For example, if one funds a third party-settled special need trust with $100,000, all of which its taxable, and files a Form 709 reporting that gift, the consequence is that the federal gift tax exemption remaining has been reduced by $100,000 to $5,330,000. This exemption amount is now also the amount remaining for federal estate tax purposes.

One issue to consider is whether or not the client even wants to make a completed gift to a third party-settled trust, because the client wants to pay all of the income taxes of the trust, meaning that the client wants the trust to be a grantor trust. Generally, a transfer to a grantor trust is not a completed gift, because the grantor retains control of the trust assets. However, if a client also wants to reduce his or her taxable estate for federal estate tax purposes, and the trust is being considered as a vehicle for gifting assets from the client to others, then the best advice is for the client to make a completed gift to a trust that would exclude the assets from his or her federal taxable estate at death. There is a hybrid use of grantor trust status that can accomplish both goals, that is, having transfers to the trust be completed gifts for gift tax purposes and retaining grantor trust status for income tax purposes. These trusts are referred to with the odd name, Intentionally Defective Grantor Trusts (“IDGT”). The trust is a grantor trust, often

containing the administrative power of the grantor to substitute trust property of equal value. All other aspects of the trust provide for complete separation of control by the grantor. Thus the grantor trust is "defective," because control by the grantor is so limited. A gift to an IDGT is a completed gift. Using an IDGT, which can be a special needs trust, can enable a grantor to pay the income tax liability for the trust as well as treat the trust assets as entirely separate from the grantor's taxable estate for federal estate and gift tax purposes.

IV. Generation-Skipping Transfer Tax

A subset of the federal gift tax and the federal estate tax is the Generation-Skipping Transfer Tax ("GST").[13] This is an extra tax on lifetime gifts or gifts from a decedent if the gift transfers to a "skip person," meaning to a person in a generation below another living person. For example, if grandpa wants to give a gift to grandchild, and the parent of grandchild who is a child of grandpa is alive, grandchild is a skip person. In this example, if the gifts exceeds the value of the remaining gift tax exemption amount available to grandpa, then there will be gift tax as well as GST tax assessed. The exemption amount for the GST tax is the same amount as the gift and estate tax exemption.

V. Federal Estate Tax

The federal estate tax is an excise tax assessed on property that passes at the death of the owner to his or her beneficiaries.[14] Property that is subject to the federal estate tax is that property over which the decedent had control at death or held a power that gave him or her sufficient control to cause inclusion in the federal taxable estate. Similar to the gift tax, there are some transfers that are exempt from tax, notably transfers to a spouse and to charities. The rate

[13] IRC §§ 2601-2664
[14] IRC §§ 2001-2058

for the federal estate tax in 2015 is 40%, assessed on the net value of the assets as of the date of death. The exemption amount for the federal estate tax is $5,430,000 in 2015, meaning that an estate valued at less than that is not subject to the tax.[15] Although the exemption amount is very high, there are circumstances when one should take the federal estate tax rules into account. For example, even if an estate value is below the exemption amount, when appreciated property transfers as a result of death, the basis "steps up" to the value of the property at the date of death, thus reducing capital gains tax on inherited assets.[16]

A. Special Needs Trusts.

1. Self-settled d(4)(A) Special Needs Trusts. It is not uncommon for a plaintiff to obtain a settlement of a significant amount as a result of injuries sustained by someone's negligence. In these cases, if the plaintiff has been permanently disabled as a result of the incident and will require substantial medical care for the rest of his or her life, it is appropriate to direct the settlement recovery to a special needs trust in order to secure eligibility for Medicaid for the plaintiff. Under Medicaid rules, funds received in a recovery are deemed to belong to the plaintiff. Therefore, the only kind of special needs trust that can be used in this planning is a d(4)(A) trust as long as the plaintiff is disabled and under age 65. For tax purposes, this trust is includable in the plaintiff's taxable estate, because he or she transferred the funds while retaining an interest in the funds, even though that interest is subject to the discretion of the trustee. Because of the payback requirement to Medicaid, however, if the medical needs of the beneficiary are substantial, it is likely that the corpus of the trust will be reduced significantly at the death of the beneficiary in order to pay the debt to Medicaid. While this may be the case,

[15] The Taxpayer Relief Act of 2013 provided for a new concept called "portability" by which any leftover exemption amount in the estate of one spouse can be transferred to the surviving spouse.
[16] IRC 1014; Treas. Reg. 1.1014-1

however, it is important that the practitioner not overlook traditional estate planning techniques to reduce federal estate tax when drafting a special needs trust that will hold a recovery over $5,430,000 in 2015.

2. Third Party Settled Special Needs Trusts. A special needs trust that is funded by a third party should take into account traditional federal estate tax planning techniques as well. While the third party special needs trust may not be includable in the estate of the beneficiary, it is important to consider the remainder beneficiaries when drafting these trusts. A third party-settled special needs trust can include generation-skipping transfer tax exemption planning so that at the death of the beneficiary, his or her children, or the other issue of the grantor, can benefit from generation-skipping tax exemption planning. If a beneficiary of a special needs trust is able to access public benefits, and if most of the needs of the beneficiary are provided by such benefits, it is likely that the special needs trust can grow in value and may not be expended during the life of the beneficiary. One can include a limited power of appointment for the beneficiary, if he or she is competent, which will not cause inclusion of the trust in his or her taxable estate, but will provide for some control over the future of the trust corpus, particularly if the beneficiary has children. By keeping in mind that this planning should benefit others in the future, a practitioner can provide good advice to a wealthy client who wants to provide significant funds that will be there if needed for a disabled family member, but will also provide prudent estate planning for other people for whom the grantor may wish to provide.

Conclusion

When planning for clients who lack capacity or may have other disabilities, providing for their special needs is paramount. However, the rules for income taxation, both for trusts and for

estates and individuals, must be considered. Interrelated with the income tax rules are the rules for capital gains, gifts and for the transfer of property at death.

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The Interplay of Income, Estate and Gift Tax

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Individual Income Tax

- Payable by individual who received benefit of income
  - Qualified Income Trusts
  - Timing of Liquidation of Retirement
- MAGI

Individual Income Tax Rates for 2015

If Taxable Income is Between:	The Tax Rate is:
0 - $9,225	10% of taxable income
$9,226 - $37,450	$922.50 + 15% of the amount over $9,225
$37,451 - $90,750	$5,156.25 + 25% of the amount over $37,450
$90,751 - $189,300	$18,481.25 + 28% of the amount over $90,750
$189,301 - $411,500	$46,075.25 + 33% of the amount over $189,300
$411,501 - $413,200	$119,401.25 + 35% of the amount over $411,500
$413,201 +	$119,996.25 + 39.6% of the amount over $413,200

Fiduciary Income Tax

- Payable by Trust, Beneficiary or Grantor
  - Income Only Trusts
  - Discretionary Trusts
  - Special Needs Trusts
  - Grantor Trusts
  - Estates
  - Depends on explicit terms of the trust

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Income Tax Rates for Trusts 2015

If Taxable Income is:	The Tax is:
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300
	+ 3.8% Medicare Surtax

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Capital Gains Tax

- Assessed on appreciation at time of sale
- Basis of Property Transferred by Sale
- Basis of Property Transferred by Gift at Death
- Basis of Property Transferred by Gift During Lifetime
- Inheriting a Life Estate
- Principal Residence Exclusion from Capital Gain

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Long Term Capital Gains Tax Rates 2015

- If seller is in 10% or 15% bracket, rate is 0
- If seller is in 25%-35% bracket, rate is 15%
- If seller is in 39.6% bracket, rate is 20%
- Also applies to trusts and estates

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Federal Gift Tax

- Direct Lifetime Transfers of Gifts
- Transfers of Gifts to Trusts
  - Gifts of Future Interests
  - Crummey Powers
- Transfers to Special Needs Trusts
  - Transfers to d(4)(A) Special Needs Trusts
  - Transfers to Third Party-Settled Trusts
- Transfers to Grantor Trusts

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Federal Gift Tax Rate in 2015

- Payable by Donor
- Gift tax rate in 2015 is 40% of net value on date of gift
- Exemption amount in 2015: $5,430,000
- Tax payable in year following year of gift

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Generation-Skipping Transfer Tax

- Applies to transfers during lifetime and at death
- Additional tax on transfers after gift tax or federal estate tax
- Transfers to skip persons or trusts that will distribute to skip persons
- Exemption amount $5,430,000 for lifetime
- Allocation of exemption amount to assets

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Federal Estate Tax

- Inclusion in taxable estate depends on amount of control decedent had over assets on date of death
- Special Needs Trusts
  - Self-settled d(4)(A) Special Needs Trusts
  - Third party-settled Special Needs Trusts

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Federal Estate Tax Rate in 2015

- Payable by estate
- Rate on net value of estate is 40%
- Exemption amount in 2015: $5,430,000
- Portability for spouses for unused portion of exemption amount of decedent
- Tax due 9 months after date of death

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Conclusion

When planning for clients who lack capacity or have other disabilities, providing for their special needs is paramount. However, the rules for income taxation, both for trusts and for estates and individuals, must be considered. Interrelated with the income tax rules are the tax rules for capital gains, gifts and for the transfer of property at death.

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PRE-CONFERENCE:

TAX INTENSIVE

Wednesday, October 14, 2015
1:00 P.M. – 2:00 P.M.

What is a Grantor Trust and When Do You Need an EIN?

Presenter:
Nell Graham Sale
Attorney at Law, Pregenzer, Baysinger, Wideman & Sale
Albuquerque, NM

- Materials
- PowerPoint

Stetson University College of Law presents:
2015 SPECIAL NEEDS TRUSTS
THE NATIONAL CONFERENCE
October 14-16, 2015
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WHAT IS A GRANTOR TRUST, AND WHEN DO YOU NEED AN EIN?

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WHAT IS A GRANTOR TRUST, AND WHEN DO YOU NEED AN EIN?

Income Taxation of Trusts

The story of grantor trusts begins with an explanation of the income taxation of trusts. There are three ways that income earned by a trust can be described. The three types of income in trusts are: "trust accounting income" as defined in Treas. Reg. §1.643(b)-1; "income" as defined in Treas. Reg. §1.671-2(b); and "distributable net income" as defined in Treas. Regs. §§ 1.652(a)-1 and 1.661(a)-2. Trust accounting income is all of the earnings of the trust which may or may not be distributed. Trust accounting income is akin to "gross income" in that it is the total of everything that is earned by the trust assets, which may include interest, dividends and capital gain.[1] Income is the earnings of the trust which are attributed for income tax purposes to the trust, the beneficiary or the grantor. It can be understood as "taxable income."[2] Distributable net income is the calculation of what has been distributed by the trust during the tax year. Distributable net income is a deduction against the taxable income of the trust. It may represent the value of principal that was distributed by the trust. A distribution of principal that is less than or equal to the accounting income of the trust will "drag out" the equivalent value of income earned.[3] Distributable net income is reported as distributed to the individual taxpayer as income, and that taxpayer must report the distribution as income.

Federal income taxation of trusts depends initially on whether a trust is categorized as a "grantor trust," in which the taxable income is attributed to the "grantor" of the trust, or a "non grantor trust," which is all other trusts. The provisions in the Internal Revenue Code ("Code")

[1] Treas. Reg. § 1.643(b)-1.
[2] Treas. Reg. § 1.671-2(b).

pertaining to taxation of non grantor trusts are found in Chapter J, Sections A through D, and the provisions in the Code pertaining to grantor trusts are found in IRC §§ 671 to 678. A non grantor trust has its own employer identification numbers ("EIN") and if the trust earns any taxable income or gross income of more than $600, it must file an income tax return each calendar year using Form 1041.

On the Form 1041, a trust may be identified as either a simple trust or a complex trust. A simple trust is one which distributes all of the income in a tax year.[4] A complex trust is every other kind of trust other than a simple trust.[5] A complex trust, for example, could be a discretionary trust, where distributions of income and principal are discretionary with the trustee. In a given year, the trustee of a discretionary trust may decide to distribute all of the income to the beneficiary. In that particular tax year, the trust would be a simple trust. However, in the following tax year, the trustee may decide to retain some of the income and reinvest it. In that tax year, the trust would be a complex trust. A qualified disability trust is a complex trust with a disabled beneficiary. Non grantor special needs trusts are generally complex trusts, because they would never be drafted to have a mandatory distribution of income each year. However, if all income were distributed, the special needs trust could be a simple trust for that tax year, and it could also be a qualified disability trust.

Trusts, like individual taxpayers, may take deductions against trust accounting income. The primary deduction and usually the largest deduction is distributable net income. The trust uses the amount of income that has been distributed as a deduction against its own taxable income. Consider the trust as a funnel and you can see that the income that it keeps is the amount that it brings in minus the amount that it sends out. The calculation of distributable net

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[3] IRC § 651; IRC § 661.
[4] IRC § 651.

income is too complex for our purposes here. However, it needs to be noted that even if the trust does not distribute trust accounting income, but instead distributes an item of principal, such as real estate, to the extent that the value of the principal that was distributed is more than or equal to the trust accounting income, the trust will report a distribution of all of its income.[6] The beneficiary of the item of principal will ordinarily receive a Schedule K-1 from the trustee reporting that the beneficiary received income even if the beneficiary did not receive any cash. This is how distributable net income works. The amount of distributable net income can be reduced by deducting expenses of the trust, such as administrative expenses or fiduciary fees.

Trusts, like individuals, have exemptions against taxable income. A simple trust, one which distributes all of its income, may take an exemption of $300 per year.[7] Therefore, the trust may report that it distributed all but $300 of its income, and reduce its taxable income to zero with the exemption. This saves the taxpayer $300 in reportable taxable income. Complex trusts have an exemption of $100.[8] Qualified disability trusts may use the amount of the personal exemption of the beneficiary as the exemption amount of the trust.[9]

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[5] IRC § 661.
[6] IRC § 652.
[7] IRC § 642(b).
[8] IRC § 642(b)(2)(A).
[9] IRC § 642(b)(C)(i).

Trusts have the same tax rates as individuals. However, the tax brackets of trusts are highly compressed. For example, in 2015, a trust will pay the highest rate of 39.6% on taxable income over $12,300.[10] Consequently, a trustee of a complex trust will want to carefully consider the income tax consequences of retaining income in the trust, because more dollars will be paid in income tax by the trust than by an individual taxpayer on the same amount of income. Furthermore, as of January 1, 2013, the Health Care and Education Reconciliation Act of 2010 imposed a Medicare surtax of 3.8% on taxpayers who are in the highest federal income tax bracket, which in 2015 is 39.6%.[11] This rate is imposed on income calculated under a new method called Modified Adjusted Gross Income ("Modified AGI or MAGI"). MAGI is defined as adjusted gross income ("AGI") increased by the excess of (a) the amount excluded from gross income under IRC § 911(a)(1), over (2) the amount of any deductions taken into account in computing AGI or exclusions disallowed under IRC § 911(d)(6) with respect to the amounts described in the previous paragraph (1).[12] MAGI includes tax exempt income and Social Security income not otherwise included in AGI. Individual taxpayers who have MAGI over $200,000 will pay the Medicare surtax. Estates and trusts, other than charitable trusts, are subject to this surtax on the lesser of undistributed net investment income or the excess of AGI in

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[10] ***2015:***

If Taxable Income Is:	***The Tax Is:***
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300 + 3.8% Medicare Surtax

[11] P.L. 111-152; IRC § 1411(a)(2)(A) & B

[12] *Id.*

excess of the highest tax bracket.[13] Therefore, trusts that retain income in excess of $12,300 in 2015 will pay federal income tax on the amount over $12,300 at 39.6%, plus pay a surtax of 3.8% on the MAGI amount, making the effective federal rate 43. 4%. Additionally, in 2015, as a result of the American Taxpayer Relief Act of 2013 ("ATRA"), non grantor trusts have even further income tax burdens. The ATRA imposes a higher capital gain rate of 20% on taxpayers in the 39.6% bracket, which for a trust occurs when taxable income exceeds $12,300.[14] For individual taxpayers, the income threshold for the 20% capital gain rate is $413,201 for single filers in 2015.[15]

As stated earlier, one of the three types of income defined in the Internal Revenue Code is simply called "income." The definition of income for trust purposes is that amount that is attributed for tax purposes to a particular individual taxpayer.[16] That taxpayer can either be the trust, the beneficiary of the trust or it can be the grantor. To whom the income is attributed is determined by the terms of the trust agreement. If a trust is a non grantor trust, the income retained by the trust will be attributed to the trust, and the income distributed will be attributed to the beneficiary. However, if a trust is a grantor trust, whether the trust is a simple trust or a complex trust, no matter who actually receives the earnings of the trust, the grantor will report on his or her Form 1040 the income earned by the trust. As drafters of trust agreements, therefore, it is very important that we understand what provisions of trust agreements will govern to whom the income for tax purposes will be attributed.

[13] *Id.*
[14] Rev. Proc. 2013-15, § 2.01, Table 5.
[15] IRC § 1(h)(1) and § 1(i)(3) as amended by ATRA §§ 101 and 102.
[16] Treas. Reg. § 1.671-2(b).

The Grantor Trust Rules

Prior to 1940, income tax rates and brackets were spread so broadly that some taxpayers transferred assets to trusts naming lower bracket taxpayers as the beneficiaries in order to reduce income tax paid on the earnings of the trust assets. However, the grantors retained significant control over the trusts. The United States Supreme Court ruled in *Helvering v. Clifford* that the income earned by the trust would be taxable to the grantor, even though the income was actually distributed to the beneficiary, because of the amount of control retained by the grantor.[17] The Internal Revenue Service ("IRS") issued regulations called the "Clifford Regulations" in 1946, and in 1954 new sections were added to the Code, which are now the grantor trust rules. While income tax rates today are not as far apart as they were in 1954, and even though the IRS targeted abuses with the grantor trust rules, those rules offer favorable opportunities for taxpayers today. The grantor trust rules are found at Sections 671 to 678 in the Code and in the accompanying Treasury Regulations at Sections 1.671-1 to 1.678(a)-1 *et.seq*.

To begin with, the Code defines what a grantor is.[18] In our practices, we usually associate the term "Grantor" with the person who creates a trust. We understand that this term can be substituted with the terms "Trustor" or "Settlor." However in the Code, the term "grantor" has a specific meaning that is somewhat broader than what we are accustomed to. In Treasury Regulation Section 1.671-2(e)(1), the term "grantor" for the purposes of the grantor trust rules can be a person who creates a trust (the meaning with which we are comfortable) or a person who makes a gratuitous transfer to a trust, directly or indirectly. (In this paper, the term "Grantor" will be capitalized when referring to the creator, Settlor or Trustor of a trust. The term "grantor," without being capitalized, will refer to the term as defined in the Code.) Therefore, a

[17] *Helvering v. Clifford*, 309 U.S. 331 (1940).
[18] IRC § 671.

person who creates a trust and has the title of Grantor according to our common meaning of the term might fit one of the definitions of grantor under the Code. However, there can be additional grantors under the Code who are persons who gratuitously transfer anything into that trust. The additional grantors can become such by either a direct transfer or an indirect transfer. What would that look like? Let's say that a parent created an irrevocable trust for a child. The parent is of course the Grantor or creator of the trust. Somewhat later, a grandparent decides to make a gift to the trust for the benefit of the child. Under Treas. Reg. Section 1.671-2(e)(1), the grandparent may also be a grantor, even though the grandparent did not create the trust. The Code provides that a married couple can be counted as one grantor.

Under the Code, once a person has become a possible grantor by creating the trust or donating to the trust, if the terms of the trust establish sufficient control in such person, then the person is deemed to be the owner of the trust property, not the trust. Thus the grandparent who transferred property in the above example could be treated as the continuing owner of the transferred property, depending on the terms of the trust. For income tax purposes, the grantor is taxed on the income earned by the property in the trust of which the grantor is deemed to be the owner. [19] The trust is ignored for income tax purposes and the income is treated as if it were distributed to the grantor, even if it is not actually distributed to the grantor. In the example of the transfer from the grandparent, if the grandparent is a grantor, the income earned by the assets in the trust that were contributed by the grandparent is attributed to the grandparent for income tax purposes. Therefore, if a drafter wants income to be attributed to the person who establishes a trust, or to persons who contribute assets to the trust but who did not create the trust, then the drafter needs to make sure that the terms of the trust agreement provide sufficient control in the grantor to establish a grantor trust.

The status of grantor in the Code is determined by who can exercise sufficient control over the trust under the terms of the agreement so as to create an ownership interest in the trust. Helpfully, the elements of control that are recognized are defined and described in the Code. If a person has any of the following powers, and if he or she created or contributed property to the trust, he or she will have grantor status. It should also be remembered that a person can renounce or relinquish such powers in order to evade grantor status.

In Section 672 of the Code, we learn that the status of the grantor trust can be defeated even if some of the following powers exist if the exercise of that power can be blocked by an adverse party.[20] An adverse party is any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust.[21] Sounds circular, doesn't it? We will see how this plays out in the following paragraphs.

1. Reversionary Interest

If the grantor retains a reversionary interest in the contributed property, this will establish a grantor trust.[22] For example, a parent creates a trust for a child, and the terms of the trust state that income and principal can be distributed for the child by the trustee, but if the child takes up gambling, the trust will revert to the grantor. This would be a grantor trust because of the reversionary interest. Even though the trustee might distribute the income to the child during the term of the trust, for income tax purposes, the income would be attributed to the parent who would pay income tax on all income earned and distributed by the trust.[23] This power pertains only to that part of the trust that is more than 5% of the value of the trust at the inception of the

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[19] *Id.*
[20] IRC § 672(a).
[21] *Id.*
[22] IRC § 673(a).

trust.[24] It does not apply to an interest that reverts to a parent of a child who dies before the age of 21.[25]

2. Retaining Power to Control Beneficial Enjoyment

If the grantor retains a power to control the beneficial enjoyment of the trust or to direct the disposition of trust assets, this creates a grantor trust.[26] In this section, we see the role of an adverse party as a way to convert what would be a grantor trust away from being a grantor trust. If the grantor retains the power to change beneficiaries, or how much a particular beneficiary will receive, and the exercise of such power does not require the consent or approval of an adverse party, the trust is a grantor trust.[27] The power given to the adverse party could defeat the grantor trust status, unless it fits one of the following exceptions.

The following powers, even if their exercise would require an adverse party's consent, will not defeat grantor trust status. These exceptions are: a power to apply income to support a dependent to the extent that the grantor would not be subject to tax; the power affecting beneficial enjoyment only after the occurrence of an event; a power exercisable only by Will unless that power is in the grantor to appoint income that has been accumulated for the grantor to dispose of without the consent of an adverse party; a power to allocate among charitable beneficiaries; a power to distribute corpus according to an ascertainable standard or for a current income beneficiary as long as the distribution of corpus is chargeable against the share of the beneficiary; a power to withhold income temporarily from a beneficiary as long as the beneficiary will ultimately receive such income; a power to withhold income during the

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[23] IRC § 673(b).
[24] IRC § 673(a).
[25] IRC § 673(b)(2).
[26] IRC § 674(a).
[27] *Id.*

disability of a beneficiary; or, a power to allocate between income and principal.[28] A power to add after-born or after-adopted children to the beneficiaries or class of beneficiaries does not confer grantor trust status.[29]

3. Retaining Certain Administrative Powers

Section 675 of the Code lists several administrative powers that, if possessed by the creator of or donor to a trust, will establish an ownership interest sufficient to obtain grantor status for that person. These powers, which may be exercised by the grantor or a nonadverse party without the approval of an adverse party, include: a power to dispose of corpus for less than fair consideration; a power to borrow from the trust without adequate interest or security; a power to borrow corpus and not repay it by the end of the tax year; a power of administration in a non-fiduciary capacity, which includes a power to vote stock, a power to direct investments, or a power to reacquire trust corpus by substituting other property of equal value.[30] By inserting any one of these administrative powers into a trust agreement, and having a person retain any of these powers, one can achieve grantor status for that person.

4. Power to Revoke

Section 676 describes one of the more straightforward powers to achieve grantor status, which is the power to revoke the trust, or the portion of the trust of which the grantor is the donor. This power must be exercisable by the grantor or a non adverse party.[31] The provision will not apply to a power that can only affect the beneficial enjoyment of the grantor for a period

[28] IRC § 674(b).
[29] IRC § 674(d).
[30] IRC § 675(1) through (4).
[31] IRC § 676(a).

commencing after the occurrence of an event such that the grantor would not be treated as the owner under Section 673 if the power were a reversionary interest.[32]

5. Income Retained for the Benefit of Grantor

Section 677 of the Code states that the grantor will be treated as the owner of any portion of a trust whose income may be distributed to the grantor or the grantor's spouse without the approval of an adverse party, or held or accumulated for future distribution to the grantor or the grantor's spouse, or may be applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.[33] This provision does not apply if the distributions of income are applied for the support or maintenance of a beneficiary for whom the grantor has an obligation of support.[34]

To Be or Not To Be

Now that we know that grantor trust status comes into being depending on how the trust is drafted, and we know what those powers are that establish a grantor trust, what are the ingredients of the decision that determine whether or not we want grantor trust status? Obviously, if a grantor wants to retain the power to revoke a trust and wants to be the primary beneficiary of all of the income, then the client has spoken and we will draft a grantor trust. All of those revocable "living trusts" that we draft are grantor trusts, because they are really self-settled custodial accounts established for convenience, incapacity planning and the avoidance of probate. Self-settled irrevocable trusts can also be grantor trusts when the grantor is the beneficiary. Examples are Income Only Trusts, Grantor Retained Annuity Trusts ("GRAT"), Qualified Personal Residence Trusts ("QPRT") and certainly d(4)(A) special needs trusts. During the lifetime and capacity of the grantor or grantors, these are grantor trusts. The issue of

[32] IRC § 676(b).
[33] IRC § 677(a).

whether or not to elect grantor trust status arises only when our client wishes to establish an irrevocable third party-settled trust for the benefit of someone else. In these cases we may elect to create a trust that is not a grantor trust or one that is a grantor trust. Thus, Hamlet's famous question comes to mind. The contemplation of these issues must also take into account the relationship of the grantor trust rules, which are income tax rules, with the gift tax and estate tax rules.

One issue to consider is whether or not the client wants to make a completed gift to a third party-settled trust. Generally, a transfer to a grantor trust is not a completed gift, because the grantor retains control of the trust assets. If a client wants to reduce his or her taxable estate for federal estate tax purposes, and the trust is being considered as a vehicle for gifting assets from the client to others, then the best advice is for the client to make a completed gift to a trust that would exclude the assets from his or her federal taxable estate.

The transfer to the special needs trust is an incomplete gift if the grantor retains sufficient control to cause inclusion in his or her estate.[35] It is not uncommon for a family to want to retain a large amount of control over a special needs trust, because often the parent is the primary caregiver and has been providing care for the disabled child for many years. Furthermore, the life expectancy of the disabled child may be shorter than other siblings. Therefore, having the client retain the inter vivos power to name other beneficiaries or future beneficiaries often fits with the facts of the situation. Retaining a testamentary power of appointment to name remainder beneficiaries would confer grantor trust status under Section 674 of the Code and would make the gift an incomplete gift.[36] Therefore, even if all of the income of the trust were distributed to the beneficiary, the grantor will have the income for income tax purposes attributed

[34] IRC § 677(b).
[35] Treas. Reg. § 25.2511-2(b).

to him or her. This will relieve the trust and the beneficiary from having to pay income tax on the earnings and distributions of the trust. It will also relieve the parent from the problem of making taxable gifts to the trust. Finally, the income earned by the trust will be taxed at the rate of the grantor, not at the rate of the trust.

There is a hybrid use of grantor trust status that can accomplish both goals, that is, having transfers to the trust be completed gifts for gift tax purposes and retaining grantor trust status for income tax purposes. These trusts are referred to with the odd name, Intentionally Defective Grantor Trusts ("IDGT"). The trust is a grantor trust, often with the administrative power of the grantor to substitute trust property of equal value. All other aspects of the trust provide for complete separation of control by the grantor. Thus the grantor trust is "defective," because control by the grantor is so limited. A gift to an IDGT is a completed gift. Using an IDGT, which can be a special needs trust, can enable a grantor to pay the income tax liability of the trust as well as treat the trust assets as entirely separate from the grantor's taxable estate for federal estate and gift tax purposes.

When Does a Trust Need a Separate EIN

A grantor trust with one grantor does not need a separate EIN.[37] If only one grantor provides the funding for a trust of which he or she retains sufficient control of the trust assets, all the trustee must do is to provide the name and Social Security number of the grantor and the address of the trust to all payers of income to the trust. Therefore, the payers will issue K-1s or 1099s to the Trustee using the Social Security number of the grantor. The grantor will report the income on his or her Form 1040. If the Trustee of the grantor trust is the same as the sole grantor, there is no need to provide a separate address of the trust to payers. An example of such

[36] *Id.*
[37] Treas. Reg. § 301.6109-1(a)(2)

a grantor trust is a d(4)(A) special needs trust. The sole grantor is also the sole beneficiary of the trust, and the grantor retains the right to all of the income of the trust. The d(4)(A) trust will always have a Trustee who is not the same person as the grantor, but that does not affect grantor trust status. Transfers to the d(4)(A) trust by the disabled beneficiary are not completed gifts, because the grantor retains the benefit of the transferred assets. The d(4)(A) trust would not file a Form 1041, and income earned would be reported on the disabled grantor's Form 1040.

GRATs, QPRTs and Income Only Trusts do not need to apply for a separate EIN if they have only one grantor, because they are all grantor trusts. A Qualified Settlement Fund ("QSF") can elect grantor trust status.[38] If the QSF holds funds that have been contributed by one defendant or payer into the settlement, the transferor can attach a statement to its own income tax return stating that it elects to treat the QSF as a grantor trust, and include the legend "§ 1.468B-1(k) Election." The QSF in that instance does not need a separate EIN or need to file a Form 1041.

Some trusts or accounts are required by regulation to obtain a separate EIN. A Qualified Subchapter S Trust ("QSST") is required to obtain a separate EIN, even if it is a grantor trust. According to the proposed regulations for ABLE accounts, each account will be required to obtain an EIN separate from the disabled beneficiary, even if all of the funds in the ABLE account were transferred to the account by the disabled person.

Non grantor trusts always need to have a separate EIN. In the area of special needs trusts, a trust that is a Qualified Disability Trust ("QDT") is a non grantor trust. In January, 2002, with the passage of the Victims of Terrorism Tax Relief Act, a new category for the income taxation of trusts was created. In addition to simple and complex trusts, we now have the

[38] Treas. Reg. § 1.468B-1(k)(2)

QDT.[39] A QDT obtains a higher tax deduction if the trust meets the requirements of the statute. A trust will qualify as a QDT if the beneficiary is disabled as defined by the Social Security Act (the "Act"), if the trust meets the definition of a disability trust pursuant to the Act, and even if remainder beneficiaries are not also disabled. The benefit of being determined to be a QDT is a significant increase in the exemption that can be taken as a deduction against taxable income by the trust. For a trust that meets the definition of a QDT, the exemption that is allowed for the trust is the allowable personal exemption for the individual beneficiary. In 2015, the personal exemption is $4,000. Therefore, if a QDT retains $5,000 of earned income, after taking the exemption amount, it would report $1,000 taxable income, and pay income tax in the 15% bracket in the amount of $150. A complex trust that is not a QDT would have only a $100 exemption, and thus would report $4,900 taxable income and pay $975 in tax in the 25% bracket. A QDT will be either a non grantor inter vivos special needs trust trust or a testamentary special needs trust.

There are occasions when a grantor trust could have its own EIN. One example would be an IDGT, when the taxpayer grantor wants to clearly segregate the assets in the IDGT from his or her own estate. A special needs trust can be an IDGT. Another example occurs when an institutional holder of an account insists that because a trust is an irrevocable trust it must have a separate EIN. The fight may not be worth having. This occurs quite often when trustees of d(4)(A) trusts are opening accounts.

To obtain an EIN, the Trustee files Form SS-4 with the IRS. There is a simple procedure for doing this on line. Note that page 4 of the instructions for the Form SS-4 specify that one does not need a separate EIN for certain grantor-type trusts. Once an EIN is obtained, the IRS

[39] 26 U.S.C. §642(b)(2)(C)(i),(ii).

will be looking for a Form 1041 to be filed for each year following the issuing of the EIN. If no Form 1041 is filed, the IRS will issue a notice of failure to file to the Trustee.

When a grantor trust has an EIN that is different from the TIN of the grantor, the Trustee is required to file a Form 1041. However, the taxpayer continues to be the grantor, not the trust or the beneficiary. Therefore, the Form 1041 is merely an informational vehicle. There are two options provided by the IRS for a grantor trust that is filing a Form 1041. The first option, which many accountants believe is the simpler one, provides that the Trustee puts only the name of the trust and its EIN on the first page of the Form 1041, but does not provide any of the financial information or tax calculations on the Form 1041. No Schedule K-1 is filed with an informational return. Using an attachment to the Form 1041, the Trustee provides the name, Social Security number and address of the Grantor. The income earned by the trust assets and any deductions taken are provided in the same detail as on the grantor's Form 1040. The grantor will then report all of the same information on his or her Form 1040.

The second option requires that the Trustee provide the EIN of the trust to all payers of income to the trust. The Trustee must file 1099s with the IRS for each item of income showing the trust as payer and the grantor as payee on all income. The 1099s will provide the Social Security number of the grantor to the IRS. The Trustee then provides an annual statement to the grantor with the detail of the trust transactions and gives notice to the grantor that he or she must pay any income tax liability incurred by trust assets.

The Trustee may switch methods of reporting from one of the two options to the other. The Trustee may also switch the method of reporting away from using the separate EIN at all,

and to not file a Form 1041. To do this, the Trustee must file a Final Form 1041, which effectively takes the EIN off the books of the IRS.[40]

To summarize this particular issue with regard to special needs trusts, the only time that the Trustee must obtain an EIN for a special needs trust is if the trust is a Qualified Disability Trust. All self-settled special needs trusts are grantor trusts and should not have to acquire an EIN that is separate from the TIN of the grantor who is the disabled person. However, some banking institutions may require a separate EIN, because they will not open the account for an irrevocable trust unless it has a separate EIN. Third party-settled grantor special needs trusts should not have to obtain a separate EIN from the grantor, unless there is more than one grantor. For federal estate and gift tax purposes, if the special needs trust is an IDGT, it may be advisable to acquire a separate EIN, but it is not a requirement. The IDGT is still a grantor trust.

Conclusion

The provisions of Sections 671 to 678 of the Code, which describe the grantor trust rules, can be regarded as mysterious, hopelessly complex, or even irrelevant. When the unified credit for federal estate tax was lower and income tax rates were higher, it may have been prudent to carefully avoid grantor trust status. However, opportunities exist today that make the use of grantor trusts very advantageous.

There is not clear advice from the IRS, nor a bright line rule in trust law, about when to use an EIN separate from the grantor's TIN for a trust. One must look at the terms of the trust to understand whether the grantor is the taxpayer or not. If the trust is a grantor trust with a single grantor, the Trustee may not need to apply for a separate EIN. If the trust is not a grantor trust, it

[40] See Instructions for Form 1041 and Schedules A, B, G, J, and K-1, page 12

must have a separate EIN. If the trust is a grantor trust, but has a separate EIN for any reason, an informational Form 1041 can be filed using an attachment to show that income is to be reported by the grantor separately from the Form 1041, or the Trustee can file 1099s using the grantor's TIN with the IRS in lieu of Form 1041.

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What is a Grantor Trust, and When Do You Need an EIN?

Tax Intensive
October 14, 2015

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Income Taxation of Trusts

- Gross earnings of more than $600 per year or any taxable income
- Depends on explicit terms of the trust
- Revocable or irrevocable trust
- Who is the taxpayer?
  - Grantor
  - Trust
  - Beneficiary

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Types of Trusts for Income Tax Purposes

- Form 1041 is the tax return for Trusts
- Form 1041 requires an Employer Identification Number, EIN. (Also called Taxpayer Identification Number, TIN)
- Trust types listed on Form 1041 include:
  - Simple Trust
  - Complex Trust
  - Qualified Disability Trust
  - Grantor type trust

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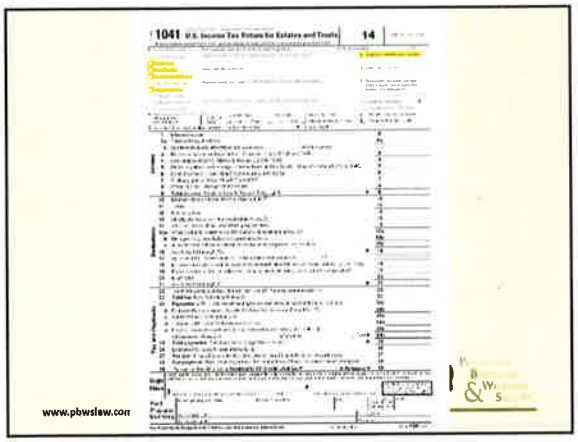
1041 U.S. Income Tax Return for Estates and Trusts
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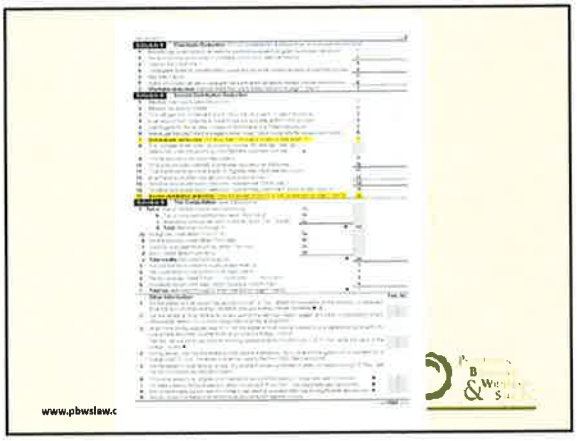
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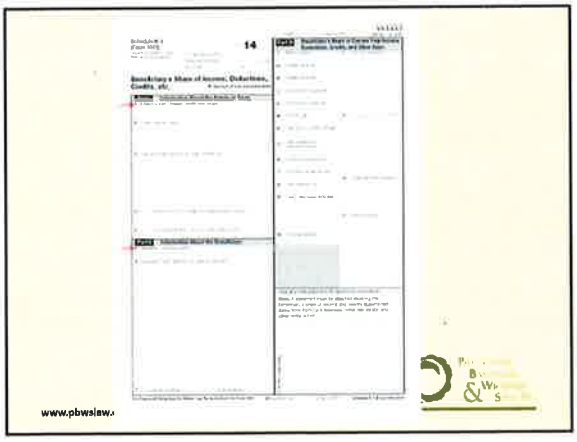
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Simple Trust

- All income required to be distributed to the beneficiary
- Examples:
  - Marital Trust
  - Trust holding subchapter S stock

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Complex Trust

- Distribution of income discretionary with Trustee
- Examples:
  - Special needs trust
  - Trust for minor child

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Income Tax Rates for Trusts 2015

- Income tax rates for estates and trusts in 2015:

If Taxable Income is:	The Tax is:
Not over $2,500	15% of the taxable income
Over $2,500 but not over $5,900	$375 plus 25% of the excess over $2,500
Over $5,900 but not over $9,050	$1,225 plus 28% of the excess over $5,900
Over $9,050 but not over $12,300	$2,107 plus 33% of the excess over $9,050
Over $12,300	$3,179.50 plus 39.6% of the excess over $12,300
	+ 3.8% Medicare Surtax

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Qualified Disability Trust

- Distribution of income discretionary with Trustee
- Must be for a disabled beneficiary
- Described in IRC § 642(b)(2)(C)(i) and (ii)
- Complex trust with higher exemption
- Example:
  - Testamentary Special Needs Trust

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History of Grantor Trust Status

- The present rules were enacted by Congress in 1954 to stem abuses by high income taxpayers who were shifting income to beneficiaries in much lower brackets and yet retaining the benefit of the assets
- *Helvering v. Clifford,* 309 U.S. 331 (1940) was the foundation of the current rules. The Court held that the income was taxable to the grantor of the trust.
- Treasury adopted so-called "Clifford Regulations" in 1946

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Grantor as Owner of Trust Property

- IRC § 671
  1. Income taxed to Grantor
  2. As if the trust did not own the corpus
  3. Pertains to any trust property that the Grantor "owns"

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Who is the Grantor?

- Treas. Reg. § 1.671-2(e)(1)

1. A person who creates a trust; or
2. A person who makes a gratuitous transfer to a trust, directly or indirectly
3. Grantor must be alive

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What Creates Ownership in the Grantor?

- Reversionary Interest in Grantor; IRC § 673
- Power to control beneficial enjoyment; IRC § 674
- Power to revoke; IRC § 676
- Income for benefit of Grantor; IRC § 677
- Certain administrative powers; IRC § 675:
  - Power to dispose of corpus for less than fair market value
  - Power to borrow from the trust at lower than market rate
  - Power not to repay loan from the trust by end of tax year
  - Power of administration in a non-fiduciary capacity
    - Power to vote stock
    - Power to direct investments
    - Power to reacquire trust assets by substituting other property of equal value

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Adverse Parties can Change Grantor Trust Status

IRC § 672

- Adverse Party: Any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or non-exercise of the power which he possesses respecting the trust.
- Example: Grantor retains the power to change beneficiaries of the trust, but such change requires the approval of a beneficiary who has a general power of appointment over the trust. Not a grantor trust.
- Certain powers cannot be abrogated by an adverse party

  Ex. Administrative powers under IRC § 675

Advantages of Grantor Trust Status

- Income tax on earnings of trust assets paid by Grantor
- Transfer to trust not treated a completed gift from Grantor, so no gift tax issues
- No need for Crummey powers for transfers to trust
- Basis of transferred assets remains the same as in hands of Grantor
- Any capital gain from sale of assets by trust taxed to Grantor

Grantor type trusts with the EIN of the Grantor

- Treas. Reg. § 301.6109-1(a)(2) provides that a grantor trust treated as owned by a single person under the grantor trust rules does not need to obtain an EIN, if the trustee furnishes the name and Social Security number of the grantor and the address of the trust to all payers of income to the trust.
  - Examples: GRAT; QPRT; d(4)(A) SNT; QSF; Income Only Trust

Reasons for Separate EIN for Trust

- Grantor is deceased
- Adverse party obtains a power to defeat grantor trust status
- Not drafted as a grantor trust
- Clear demarcation of ownership of assets
- Institutional holder of trust insists on EIN
- Required by IRS: ABLE accounts; Qualified Subchapter S Trusts

Intentionally Defective Grantor Trust (IDGT)

- Grantor Trust status obtained using a power not affected by adverse party
- Grantor is not the Trustee and retains no other powers to control trust assets
- Gifts to IDGT are completed gifts
- Gifts to IDGT not included in Grantor's taxable estate
- IDGT can have its own EIN

Obtaining an EIN for the Trust

- Form SS-4 used to obtain EINs
- Page 4 of the SS-4 instructions regarding EINs for trusts states "Do not file this form for certain grantor-type trusts. The Trustee does not need an EIN for the trust if the trustee furnishes the name and TIN of the grantor/owner and the address of the trust to all payers."

Grantor type trusts with an EIN different than the Grantor

First option

- Form 1041 instructions provide two options when the grantor trust with one Grantor has an EIN other than that of the Grantor. The first is an attachment to Form 1041.
  - Fill in only the entity information on Form 1041 and no dollar amounts. Do not use Schedule K-1
  - On an attachment, give the name, Social Security number and address of the Grantor
  - Report the income and deductions in the same detail as would be used on the Grantor's 1040
  - The Grantor must report all trust income on his or her own 1040

Grantor type trusts with an EIN different than the Grantor

Second option

- The Trustee must give all payers of income the EIN of the trust
- The Trustee must file 1099s with the IRS to report income paid to the trust during the tax year with the trust as payer and the Grantor as payee. A separate 1099 is required for each item of income. The 1099s must be filed by March 2 of the year following the tax year.
- The Trustee must provide to the Grantor a statement that shows all income and deductions of the trust and explain how to report these items on the Grantor's 1040, and must inform that Grantor that those items must be reported.

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Grantor type trusts with an EIN different than the Grantor

- The Trustee can switch methods of reporting using the Form 1041 from one year to the next
- If the Trustee had filed the Form 1041 previously, it can file a Final Form 1041 stating that it is for a grantor trust, and use an optional reporting method in the future.

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EINs for Special Needs Trusts

- Non grantor special needs trusts must have an EIN and file Form 1041
- Trust or beneficiary pays income tax

Examples:

Testamentary special needs trust

Qualified disability trust

Non grantor third party special needs trust

Grantor Special Needs Trusts

- Grantor special needs trusts do not have to have an EIN separate from the Grantor
- Grantor pays income tax

Examples:

d(4)(A) trusts

Grantor third party settled trusts

Conclusion

There is not clear cut advice from the IRS about when to use an EIN separate from the Grantor's TIN for a trust. One must look at the terms of the trust to understand whether the Grantor is the taxpayer or not. If it is a grantor trust with a single Grantor, the trustee may not need to apply for a separate EIN. If it is not a grantor trust, the trust will need a separate EIN. But, if it is a grantor trust, but has a separate EIN, an informational Form 1041 can be filed using an attachment to show that income is to be reported by the Grantor separately from the Form 1041, or the Trustee can file 1099s using the Grantor's TIN with the IRS in lieu of the Form 1041.

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PRE-CONFERENCE:

TAX INTENSIVE

Wednesday, October 14, 2015
2:00 P.M. – 3:00 P.M.

IRAs, Qualified Plans, Pensions, etc. with the SNT Named as Beneficiary

Presenter:
Bradley J. Frigon
Attorney at law, Law Offices of Bradley J. Frigon
Englewood, CO

- Materials
- Exhibits A-H
- PowerPoint

Stetson University College of Law presents:
2015 SPECIAL NEEDS TRUSTS
THE NATIONAL CONFERENCE
October 14-16, 2015
The Vinoy Renaissance Resort & Golf Club
St. Petersburg, Florida

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IRAs, Qualified Plans, Pensions, etc. with the SNT Named as Beneficiary

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TABLE OF CONTENTS

I. INTRODUCTION

As lawyers doing special needs trusts planning, the majority of our attention is directed at securing or protecting our client's eligibility for public benefits and providing for their special needs. Retirement plans can be a useful tool in achieving these goals, but only if a thorough analysis of the applicable rules is undertaken to ensure that the outcome is the one that is intended. This article will review the applicable retirement plan rules and how they work with third party and first party special needs trusts.

II. RETIREMENT PLAN BASICS - HOW TO TALK THE TALK

A. What are Retirement Assets?

- Individual Retirement Accounts (IRAs)
- SEP-IRAs
- Simple Plans
- Keoghs
- 403(b) Plans
- Defined Contribution Plans
  - Money Purchase
  - Profit Sharing
  - 401(k) Plans
- Defined Benefit Plans

B. Retirement Assets Are Income in Respect to a Decedent

Income in Respect to a Decedent (IRD) refers to all items of taxable income of a decedent that are not properly taxable to the decedent on his or her last or prior income tax return.[1] **IRD is not entitled to a step-up basis under I.R.C. § 1014. As a result, IRD is always subject to income tax and may be subject to estate and generation skipping taxes. The beneficiary of the retirement asset is responsible for the income tax.**[2]

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[1] I.R.C. § 691(a).

[2] If the estate is subject to federal estate tax, the recipient of the IRD asset may be eligible for an offsetting income tax deduction under I.R.C. § 691(c). The IRD recipient claims the IRD deduction as a Schedule A itemized deduction.

C. Required Beginning Date (RBD)

A participant must begin taking required minimum distributions (RMDs) from his or her retirement account by the required beginning date (RBD).[3] The RBD is April 1st of the calendar year AFTER the calendar year in which the beneficiary turns 70 ½.[4]

Example:

Bob is born on 6/30/1942
Bob turns 70 on 6/30/2012
Bob turns 70 ½ on 12/30/2012
Bob's RBD is 4/01/2013

Jane is born 7/1/1942
Jane turns 70 on 7/1/2012
Jane turns age 70 ½ on 1/1/2013
RBD is 4/1/2014

D. Required Minimum Distributions (RMDs)

RMDs must begin once a participant reaches his or her RBD. RMDs are calculated based upon the Uniform Table.[5] A participant's RMD is calculated under the Uniform Table by dividing the factor into the balance of the participant's retirement account as of December 31 as of the previous calendar year.

Example: In 2013, Bob will be 75 years old. The balance of his retirement account as of December 31, 2012 is $287,500.00. Bob's RMD is $12,555.00 ($287,500 divided by 22.9).

[3] RMD does not apply to Roth IRA accounts.

[4] For qualified plans only, RBD rules do not apply to participants who are five percent or greater owner of the business and are not retired at age 70 ½..

[5] See Exhibit A.

The only exception to the use of the Uniform Table occurs when the participant's spouse is more than ten years younger than the participant. When the spouse is more than ten years younger, the participant has the option to use the Joint Life Expectancy Table.

E. Distributions at Death.

To determine the RMDs to the successor beneficiary after a participant passes away, you must know the following information:

1. Did the Participant die before or after his or her RBD?
2. Are there multiple beneficiaries?
3. Does the retirement account pass to a "**Designated Beneficiary**", and who is the designated beneficiary?

The beneficiary of a retirement account must be determined by September 30 of the year following the year of the participant's death. This allows time for disclaimers to be filed, or separate accounts established for multiple beneficiaries.

F. Inherited IRA -Death Before Required Beginning Date

1. Spouse as Designated Beneficiary

A spouse has the option to rollover the participant's retirement account into an IRA in the spouse's name. To be eligible to rollover the IRA, the spouse must be named as the sole beneficiary of the retirement account. If the spouse elects to rollover the retirement account, the spouse can defer distributions until the spouse's RBD.

The spouse can treat the IRA as an "Inherited IRA" account. Under this option, RMDs will be calculated based upon the spouse's life expectancy under the Single Life Expectancy Tables. Each year, the spouse is allowed to "recalculate" his or her RMDs under the table. To recalculate, the spouse simply finds the factor associated with his or her age.

2. Non Spouse Designated Beneficiary.

Beneficiary's Life Expectancy. If the participant dies prior to the RBD, with a designated beneficiary other than the surviving spouse, RMDs will be made based upon the designated beneficiary's life expectancy using the Single Life Table.[6] To calculate the RMD, the

[6] Exhibit A.

beneficiary divides the balance of the account by the factor assigned to his or her age from the Single Life Table. The beneficiary's age is determined at the participant's death. Each year, the beneficiary simply subtracts one from his or her initial factor.

> **Example:** If the beneficiary is 58 when the participant dies, the factor to determine the first RMD is 27. The following year, the beneficiary's factor to determine the RMD would be 26 (27-1).

G. Inherited IRA- Death After the Required Beginning Date

1. Spouse as Designated Beneficiary

As previously explained, the spouse always has the option to rollover the IRA provided the spouse is the sole designated beneficiary. If the spouse treats the IRA as an "Inherited IRA", and the participant died after his or her RBD, the spouse has the option of taking distributions based upon the greater of the spouse's life expectancy under the Single Life Tables (recalculated) or the life expectancy of the participant (without the recalculation option).

2. Non Spouse Designated Beneficiary

Distributions Over the Greater of the Beneficiary's or the Participant's Life Expectancy. When the participant dies after RBD with a designated beneficiary who is not the surviving spouse, RMDs are calculated based upon the greater of the beneficiary's life expectancy or the participant's life expectancy using the Single Life Tables.

To determine the RMD, the beneficiary would locate the factor associated with the beneficiary's age as of the participant's date of death (or the factor assigned to the participant's age if the participant is younger than the beneficiary). Each year, the beneficiary simply subtracts one from his or her initial factor.

> **Example:** If the beneficiary is 58 when the participant dies, the factor to determine the first RMD is 27. The following year, the beneficiary's factor to determine the RMD would be 26 (27-1). If the participant was 50 when he died, the beneficiary could use a factor of 34.2 for calculating the RMDs.

The designated beneficiary must take the first distribution by December 31 of the calendar year after the year in which the participant died. If the beneficiary fails to take the first RMD by that date there will be an automatic election to default to the five-year rule.

H. No Designated Beneficiary

If the participant does not have a designated beneficiary and died before his or her RBD, then the retirement plan assets must be distributed under the five-year rule.[7] After the participant reaches his or her RBD with no designated beneficiary, then the retirement plan assets are distributed out over the participant's remaining life expectancy under the single life table.

- The following entities are not treated as designated beneficiaries:
  - Estate
  - Charity
  - Non-Qualified Trust
  - Other Entity, such as a corporation or partnership.

I. Five-Year Rule

Under the five year rule, all the retirement assets must be distributed to the beneficiary no later than December 31 of the calendar year five years from the participant's death. There is no requirement that the retirement assets be distributed equally over the five years. The beneficiary may wait until the fifth year to distribute the entire balance of the retirement account.

J. Multiple Beneficiaries

If there are multiple beneficiaries whose interests do not constitute separate accounts, then the following rules apply:

1. Unless all the beneficiaries are individuals or a qualifying trust, then the participant does not have a "designated beneficiary."
2. If all the beneficiaries are individuals, or a qualifying trust, then you must use the life expectancy of the oldest designated beneficiaries for all the beneficiaries or the five-year rule applies.

[7] I.R.C. § 401(a)(9)(B)(ii).

The Code provides two possible ways to get around the multiple beneficiary rule:

1. Separate Accounts. If you can divide each beneficiary's share into a separate account, then each beneficiary can use their own life expectancy. The regulations reference "establishing" a separate account after the death of the participant[8]. Therefore, a bequest of separate interests to each beneficiary will not create separate accounts. It is necessary to contact the retirement plan custodian and physically divide the account into separate shares. You should note that the separate account rule does **NOT** apply to multiple beneficiaries who take their interest through a trust that is named as a beneficiary of the retirement plan.
2. Disclaimer. Disclaimers will be discussed in more detail later on in Section V.

K. Titling an Inherited IRA Account.

For inherited IRA accounts, you should request the custodian to title the account as follows:

- John Doe, (Deceased) IRA fbo John Doe, Jr.
- John Doe, (Deceased) IRA fbo John Doe, Jr., Trustee of the Jane Doe Special Needs Trust, as created under the John Doe Living Trust Agreement, Dated May 1, 2004.
- John Doe, (Deceased) IRA fbo John Doe, Jr., Trustee of the Jane Doe Special Needs Trust, as created under the Last Will and Testament of John Doe, Dated May 1, 2004.

You should not retitle the inherited IRA account in the name of the beneficiary.

III. NAMING A TRUST AS A BENEFICIARY OF A RETIREMENT ACCOUNT

After the death of a participant, the remaining balance of the retirement account may be distributed over the life expectancy of the beneficiary if the participant has a "Designated Beneficiary." Under the general rule, a designated beneficiary must be an individual. A trust

[8] Reg. Sec.1.401(a)(9)-8.

will meet the definition of a designated beneficiary, for the minimum distribution rules, if the trust meets the following requirements:

1. The Trust must be valid under state law, or would be but for the fact that there is no corpus[9];
2. The trust is irrevocable or will, by its terms, become irrevocable upon the death of the participant[10];
3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the participant's benefit, must be "identifiable from the trust instrument"[11]; and
4. Certain documentation must be provided to the plan administrator[12].

A. Determination Date

The date when the beneficiaries must be determined is September 30 of the calendar year that follows the calendar year of the account owner's death. Example: Sarah died on April 29, 2012. The determination date for her IRA and QRP accounts will be September 30, 2013. The minimum distributions will be computed based only on the beneficiaries who still have an interest on the determination date. If a beneficiary's interest is eliminated between the time that the account owner died and the determination date – for example by a cash out or a disclaimer – then that beneficiary will not have any impact on the required minimum distributions

B. Conduit Trusts

If the trust meets the above requirements, the beneficiaries of the trust[13] (and not the trust itself) will be treated as a designated beneficiary.[14] In other words, the IRS will look through

[9] There is no PLR, regulation, or other IRS pronouncement giving an example of a trust that would flunk this requirement.

[10] A trustee's power, after the participant's death, to amend the administrative provisions of the trust should not be considered a power to "revoke." However, the IRS has never given an example of a trust that does not become irrevocable at the participant's death.

[11] "A designated beneficiary need not be specified by name in the plan or by the employee to the plan ... so long as the individual who is to be the beneficiary is identifiable under the plan. The members of a class of beneficiaries capable of expansion or contraction will be treated as being identifiable if it is possible to identify the class member with the shortest life expectancy." Reg. Sec. 1.401(a)(9)-4, A-1.

[12] The deadline for supplying this documentation with respect to post-death distributions is October 31 of the year after the year of the participant's death. Reg. Sec. 1.401(a)(9)-4, A-6(b). This deadline is one month after the beneficiary finalization date.

[13] Provided all of the beneficiaries named in the trust are individuals.

[14] Reg. Sec. 1.401(a)(9)-4. A-5(a).

the trust directly at the beneficiary to determine if the participant has a designated beneficiary. This type of trust is commonly referred to as a **"See Through Trust"** or a **"Conduit Trust**." You should remember that the "Separate accounts" treatment and the spousal rollover options are not available to any trust, even a see-through trust.

Neither the Code nor the Regulations use the term "Conduit trust" or "See Through Trust". Both terms have been adopted as a common usage name for a trust under which the trustee has no power to accumulate retirement plan distributions in the trust. With a conduit trust, the trustee is required, by the terms of the governing instrument, to distribute the RMDs to the beneficiaries of the trust on a current basis so that no amounts distributed from the qualified plan or IRA during the current beneficiaries' lifetimes are accumulated for the benefit of subsequent beneficiaries.[15] The trustee has no power to hold or retain in trust *any* plan distribution made during the lifetime of the conduit trust beneficiary.

If the designated beneficiary (or life beneficiary of the conduit trust) lives to his life expectancy, he will have received 100 percent of the benefits and the remainder beneficiary will receive nothing.[16]

The IRS considers the conduit beneficiary as the sole beneficiary of the trust. All beneficiaries other than the conduit beneficiary are considered mere potential successors and are disregarded. The retirement benefits are deemed paid "to" the individual conduit trust beneficiary for purposes of the minimum distribution rules, and accordingly the "all beneficiaries must be individuals" test is satisfied. Any remainder beneficiaries are disregarded for purposes of calculating the RMDs because the IRS regards them as mere potential successors to the conduit beneficiary's interest.[17]

C. Accumulation Trusts

If it is necessary to qualify a beneficiary for a means tested public benefits program such as Medicaid or SSI, a conduit trust is not going to be a very workable option. If the trust requires that all RMDs are passed through to the beneficiary, you will disqualify the beneficiary from receiving means tested public benefits.

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[15] Reg. Sec. 1.401(a)(9)-5, A-7(c)(3).

[16] For trust accounting purposes the Uniform Principal and Income Act requires a portion of the distribution to be set aside for the remainder beneficiaries unless the document directs otherwise.

[17] Reg. Sec. 1.401(a)(9)-5, A-7 (c)(3).

To maintain the disabled beneficiary's eligibility for public benefits, the trustee must be given the power to accumulate RMDs in the trust. With an accumulation trust, you will be required to use the life expectancy of the oldest potential remainder beneficiary for purposes of calculating the RMD. This is not always a straightforward process. Under the regulations, if the first beneficiary has a right to all income for life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary, both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy as the measuring life for RMD purposes.[18]

The problem is knowing when we can stop searching for remainder beneficiaries. This issue was addressed in PLR 2004-38044. The facts in the PLR were as follows: A designated his trust as the primary beneficiary of his IRA. The terms of A's trust benefitted his spouse for her life and upon A's spouse's death, the remaining trust assets were to be divided among A's "lineal descendants then living," with each descendant's share held in trust until age 30. The participant was survived by his spouse and all three living children who had already attained the age of 30.

Since the spouse's share was limited to life income plus principal in the trustee's discretion, it was necessary to determine which other beneficiaries were "designated beneficiaries" for the RMD rules. Under the ruling, the IRS decided that we can stop searching at the child level "because they will take their share outright when the prior beneficiary (the spouse) dies." If a child was under the age of 30 when the father passed away, it would be necessary to count, as trust beneficiaries, the class of beneficiaries that would inherit had the child died before the age of 30.[19]

Additional complications may surface if the remainder interest in your trust is subject to a power of appointment upon the death of the life beneficiary. The RMD rules require that all potential appointees, as well as those who would take in default of the exercise of the power of appointment, are potentially considered as "beneficiaries." Consider the following situations:

1. **Power to Appoint to "issue"** A trust that provides discretionary income and principal to beneficiary A. Upon A's death, the remaining principal and income of the trust shall be paid to such persons among the class consisting of the

[18] Reg. Sec. 1.401(a)(9)-5, A-7(c).

[19] *See e.g.*, PLR 2002-28025; PLR 2006-10026.

beneficiary's issue, as beneficiary A shall appoint by his or her will**.** Since A's power to appoint is limited to a clearly-defined group of identifiable younger individuals, the power of appointment does not create a problem for determining the RMDs.

2. **Power to Appoint to a Charity.** A trust that provides discretionary income and principal to beneficiary A. Upon A's death, the remaining principal and income of the trust shall be paid to such members of a class consisting of the beneficiary's issue and any charity as beneficiary A appoints in his or her will. Since A's power to appoint includes a power to appoint to a non-individual, the trust would not have a designated beneficiary for purposes of the RMD rules.

IV. TRUST PLANNING CHOICES FOR BENEFICIARIES OF SPECIAL NEEDS TRUSTS

A. Accumulation Trust

There are various options available for a trust intended to provide for a beneficiary with a disability. Which type is best suited for any situation depends on whether the beneficiary needs to qualify for need-based government benefit programs and who is designated as the remainder beneficiary.

A conduit trust is not suitable if the beneficiary must qualify for SSI/ Medicaid. With a conduit trust, the RMDs must be distributed to the beneficiary, and would be considered income to the beneficiary, thus jeopardizing the beneficiary's eligibility for public benefits. However, if qualification for public benefits is not an issue (for example, because the family is wealthy and intends to provide for all of the beneficiary's care), a conduit trust would be a suitable, especially if the donor wants the remainder interest to pass to a charity.

To preserve public benefits, the trustee of a special needs trust must have discretion regarding the distribution trust income and principal for the benefit of the disabled individual. Generally, the trust will prohibit mandatory trust distributions for the beneficiary's needs that are provided by government programs such as support and health care. Such a trust would be considered an accumulation trust for RMD purposes.

If this kind of trust is used, a charity should not be named as a remainder beneficiary. The chosen remainder beneficiaries should be (as siblings typically are) individuals close in age to (or younger than) the disabled beneficiary since the life expectancy of the oldest member of the group will be the applicable distribution period. Thus, designating a special needs trust as the beneficiary of a retirement account is less of problem if the disabled individual has living siblings who are younger or close in age. As the age gap widens with the disabled beneficiary being the youngest, the RMDs become more of a problem.

For example, a father establishes a stand alone SNT for his disabled son A and designates the SNT as the primary beneficiary of his IRA. The father's retirement account has a $250,000 balance at the time of his death. The terms of the SNT give the trustee the discretion to distribute the principal and income of the SNT for the special needs of A. Upon A's death, the balance of the assets of the SNT will go to A's siblings, B and C. A is 35, B is 38, and C is 42 on their father's death. In this case, the RMD rules require A, B, and C to be considered as beneficiaries. C's life expectancy will be used to determine the RMD because C is the oldest. However, in this case as in many cases the difference between the ages will cause a negligible difference in the RMD.

The factor for C at age 42 is 41.7. This means that the RMD based on C's life expectancy will be $5,995.20 ($250,000 ÷ 41.7). If the RMD were to be based on A's life expectancy then it would use the factor of 49.4. Therefore the RMD based on A's life expectancy would be $5,060.73 ($250,000 ÷ 49.4). By naming C as a remainder beneficiary, the RMD has increased by $934.47.

The RMD increases by the difference in life expectancy between A and C, which is seven years. Although in this example the increase was $934.47 for the year, it would be an area of concern if there was a large difference in ages between the intended beneficiary of the special needs trust and the oldest of the remainder beneficiaries. A large age gap could result in a significantly higher withdrawal.

For example, let's say that A is 20 and the primary beneficiary of the SNT with a $500,000 balance. A's siblings are B who is 40 years old and C who is 45 years old on their parent's death. B and C are successor remainder beneficiaries for the SNT and thus the oldest will be used as the life expectancy for calculating the RMD. If A's life expectancy were used for the RMD, the factor would be 63. The RMD based on this factor would be $7,936.50 ($500,000

÷ 63). However, C's life expectancy will be used and that factor is 38.8. That results in an RMD of $12,886.60 ($500,000÷ 38.8). In this case, the RMD will be $4,950.10 greater because C was named as a successor beneficiary than if A's life expectancy had been used in calculating the RMD.

Additionally, it is important that any provisions that are added to the trust are carefully reviewed to ensure that they will not cause a problem with regard to these rules. For example, naming a charity as a potential remainder beneficiary will ensure that the trust does not qualify as an accumulation trust under the rules.

B. Charitable Remainder Trust Planning

Another option that should be considered is a lump-sum distribution of all or a portion of a taxable retirement account to a *charitable remainder trust* (CRT) that may first benefit the surviving spouse, then other beneficiaries (such as children), and then a charity. The principal income tax advantage is that a CRT is a tax-exempt trust, so there will be no income tax liability when it receives the income from the retirement plan account.

The charitable remainder unitrust (CRUT) will commence payments to the next beneficiaries (children) upon the death of the surviving spouse. A CRUT must annually distribute at least 5% of the value of its assets, recalculated annually. The general rule concerning distributions from a charitable remainder trust (CRT) to another trust limits distributions to a term of 20 years. However, a CRT may make distributions to an individual for his or her life. Both of these general rules are a problem for persons with disabilities. A direct distribution from a CRT to an individual on SSI or Medicaid will likely cause those benefits to be lost because the distributions would create excess income or resources above means-tested program limits. But, if the CRT distributed directly to an SNT for the individual, then the payments must be limited to 20 years.

The IRS addressed the issue on whether the terms of the CRT making distribution to another trust must be limited to a term of 20 years or the life of the beneficiary in Revenue Ruling 2002-20[22]. Revenue Ruling 2002-20 provides that CRT distributions can be made to a second trust, for the life of an individual who is "financially disabled" under three situations. The ruling states that an individual shall be determined to be "financially disabled" if the

[22] Rev. Rul. 2002-20, 2002-17 I.R.B. 794 (Apr. 29, 2002). See Exhibit F.

individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuance period of not less than 12 months. An individual shall not be considered to have such an impairment unless proof of the existence thereof is furnished in such form and manner as the secretary may require.

The Ruling outlines three situations that allow a CRT to use the life expectancy of the beneficiary of the second trust and not a 20 year term. Each situation requires the beneficiary of the second trust to be an individual who is "financially disabled".

The first situation involves a CRT (Trust A) making its required payments to a support type trust (Trust B) established for the life of a beneficiary (beneficiary C). The terms of the "support trust" in Situation 1 are as follows: "A designated portion of the amount received from Trust A will be paid to C each month. If, at any time in the sole judgment of the trustee, the monthly payment to C is insufficient to provide adequately for C's care, support and maintenance for any reason, additional amounts will be paid as needed to or on behalf of the beneficiary from Trust B. Upon C's death the balance of Trust B would be paid to C's estate."

In Situation 2, a Third Party SNT receives the required payments from a CRT. Upon the beneficiary's death, the amount remaining in the SNT is required to be distributed to the beneficiary's estate. Notice that Situation 2 does not allow the balance of Trust B to be distributed to remainder beneficiaries (thereby avoiding a probate and possible estate recovery of Medicaid benefits).

The third and final situation presented in Revenue Ruling 2002-20 involves a Self-Settled SNT. While this fact pattern is not as likely as the one with a Third Party SNT, there are circumstances in which this might be used. In this situation, a CRT makes its required payments to a Self-Settled SNT, which provides that after satisfaction of any required payback to Medicaid following the beneficiary's death, the remainder of the SNT assets pass pursuant to the beneficiary's power of appointment, or if not exercised, in equal shares to the beneficiary's sister and to a charity. There are no limits on who may be appointed to receive the remaining trust proceeds.

C. Disclaimers of Retirement Benefits

A disclaimer is the refusal to accept a gift or inheritance. Federal tax law recognizes that a person cannot be forced to accept a gift or inheritance. Therefore a disclaimer itself (provided it meets the requirements of § 2518) is not treated as a taxable transfer.[23] For tax purposes, the person making the disclaimer never accepted the property in the first place, therefore the theory goes, he never owned it and therefore could not have given it away. For SSI/Medicaid purposes, a disclaimer will be treated as a transfer of assets. [24]

Disclaimers of inherited retirement benefits can be very useful in post mortem planning even when dealing with special needs planning. However, the order of who disclaims and when will be critical. For example, you will create a period of ineligibility or be forced to create a first party pay-back trust if you named the beneficiary with a disability as your primary beneficiary and then disclaimed. Even if your contingent beneficiary was a special needs trust, a disclaimer by the disabled beneficiary to his or her special needs trust would create a period of ineligibility.

On the other side of this issue, a disclaimer is an effective means to eliminate an older beneficiary, power of appointment or charitable beneficiary that impacts RMDs for the special needs beneficiary. Acceptance of required minimum distributions ("RMDs") by the primary beneficiary of retirement accounts following the participant's death prevents the beneficiary from disclaiming both the RMDs and the income attributable to the RMDs. However, the beneficiary may validly disclaim the balance of the retirement accounts.[25]

In PLR 200521033, the surviving spouse was the designated beneficiary of the decedent's IRA. The contingent beneficiaries were the marital trust under the participant's trust instrument, followed by the credit shelter trust and finally the decedent's daughters. The surviving spouse was the beneficiary of both the marital trust and the credit shelter trust and had limited testamentary powers of appointment over each. The surviving spouse sought to disclaim a fractional interest in the IRA and post-death income attributable to that interest. In addition, the surviving spouse proposed to disclaim all beneficial interests in marital trust and the limited power of appointment over the credit shelter trust. The IRS ruled that the surviving spouse could make a qualified disclaimer with respect to the limited power of appointment over the credit

[23] I.R.C. § 2518(a).

[24] POMS 01730.46.

[25] PLR 201245004 (November 9, 2012); PLR 201125009 (June 24, 2011).

shelter trust, even though the surviving spouse would retain a lifetime beneficial interest in the credit shelter trust.

Additionally if your parents are unsure of the extent the beneficiary will need to access needs based public benefits, a customized beneficiary designation form that allows the surviving spouse to disclaim to a third party snt is an effective means to take a second look at the situation upon the death of the first spouse.[26]

If disclaimers will be used, you must strictly follow the rules. Unfortunately, not every refusal to accept an inheritance is a qualified disclaimer, entitled to the blessings of § 2518. The following are the requirements for a qualified disclaimer under § 2518:

1. The disclaimer must be irrevocable, unqualified (unconditional), and in writing.[27] Verbal, revocable, and conditional disclaimers are not qualified disclaimers.
2. The disclaimant must not have "accepted the interest disclaimed or any of its benefits."[28]
3. The disclaimer must be delivered by a certain deadline. For retirement plan death benefits, the deadline is normally nine months after the participant's date of death.
4. The disclaimer must be delivered to the correct party(ies).
5. The property must pass, as a result of the disclaimer, to someone other than the disclaimant.
6. The property must pass, as a result of the disclaimer, to whoever it passes to without any direction on the part of the disclaimant. Disclaimers in favor of the spouse are NOT excepted from this rule.[29] However, if there is an express or implied agreement that the disclaimed interest in property is to be given or bequeathed to a person specified by the disclaimant, the disclaimant will be treated as directing the transfer of the property interest.[30]

[26] Exhibit D - Sample Beneficiary Designation Form.
[27] I.R.C. § 2518(b).
[28] I.R.C. § 2518(b)(3).
[29] Treas. Reg. § 25.2518-2(e)(4); 2(e)(5).
[30] Treas. Reg. § 25-2518-2(e)(1).

7. A disclaimer can be qualified under § 2518 even if it is not valid under state law.[31]

The income tax effects of a qualified disclaimer that is not valid under state law are uncertain.

D. Decanting

Decanting may be an option to remove an older beneficiary or a nondesignated beneficiary provided the impermisible or problem beneficiaries are removed by the September 30th deadline. Currently, there are no rulings by the IRS on whether decanting is an effective means to correct an existing trust with older or nondesignated beneficiaries. Additionally, it is unclear whether a state Medicaid office would take the position that a decanting of an existing third party snt constitutes a transfer without consideration by the snt beneficiary.

E. Reformation

Private Letter Rulings have discussed a court's modification of a trust or beneficiary designation made by the settlor of a trust or the IRA owner with varying results, depending on the specific facts of the case. In PLR 200742026, the IRS refused to recognize a retroactive beneficiary designation made by the court when the decedent failed to name a contingent beneficiary (although there was no disagreement that the decedent intended to name one) after a new IRA custodian began administering the IRA. In other limited circumstances, such as in PLR 200620026, the IRS has not taken issue with court orders modifying designations. For example, the IRS respected the court order in PLR 200616041, which corrected an IRA administrator's failure to implement the decedent's instructions for naming beneficiaries.

In Private Letter Ruling 201021038[32], the IRS refused to respect the retroactive reformation of a testamentary trust ordered by State Court for the purposes of complying with the "designated beneficiary" rule in the Treasury Regulations.[33] The facts are as follows: children of a decedent couple created a joint revocable trust. Upon their death, the trust was to divide into "protective trusts" created for their children. The terms of the protective trust provided that a beneficiary could appoint the trust assets to certain people and entities. This

[31] I.R.C. § 2518(c)(3).

[32] Priv. Ltr. Rul. 201021038 (May 28, 2010).

[33] § 1.401(a)(9)-4.

special power of appointment could have been exercised during the beneficiary's lifetime after a certain age or upon death.

The Trustees realized that there was a problem...the trust document clearly reflected the grantors' intent that the trust qualify as a "see-through" trust, thus avoiding the requirement that distribution of an IRA must be within five years and instead, using the life expectancy of the oldest beneficiary to calculate the required minimum distributions from the IRA. The applicable regulations provide that to qualify, (1) the trust must be valid under state law; (2) the trust must become irrevocable upon the death of the participant; (3) the beneficiaries of the trust must be identifiable from the trust instrument; and (4) the trust documents must be timely provided to the plan administrator. The terms to the trust clearly violated the "identifiable beneficiary" requirement. The same year as the surviving spouse died, the Trustees sought and obtained an order from the State Court to modifying the trust to provide, among other things, that decedents of the decedent couple born before 1955, contingent beneficiaries, and charities could not be named as potential appointees of a beneficiary's lifetime power of appointment.

Despite the court order, the IRS refused to give effect to the retroactive reformation because charities were potential contingent beneficiaries of the trust and only individuals can be "designated beneficiaries" for the purposes of satisfying 401(a)(9). The IRS reasoned that generally, the reformation of a trust instrument is not effective to change the tax consequences of a completed transaction. The IRS's interpretation in this PLR appears to be at odds with earlier PLRs where the IRS respected a trust reformed after the IRA owner's death to qualify as a designated beneficiary, in part because of the regulation that permits the beneficiary of an IRA to be determined by September 30 of the year following death (which would also have been applicable in this case).

V. FIRST PARTY (D)(4)(A) TRUSTS AND INHERITED IRAS

A. Private Letter Ruling 200620025[34]

This Private Letter Ruling was brought about when Taxpayer A died while owning an Individual Retirement Account (IRA). This IRA named his four sons as beneficiaries through a

[34] Exhibit E.

beneficiary designation. One of his sons was a minor and receiving Medicaid benefits. However, if he received the money from the IRA distribution he would lose his Medicaid eligibility.

The share for each of the son's brothers was set aside in sub-IRA accounts for their benefit. The son's share was not distributed from the IRA. However, the required minimum distributions were made to his guardian on his behalf.

The disabled son's mother was his legal guardian. She sought and obtained an order from the State Court authorizing the creation of a special needs trust for her son's benefit. The trust authorized by the court was a first party special needs trust with a payback provision. This means that the son is the sole beneficiary of the trust during his lifetime and the trustee (his mother and guardian) can distribute as much principle and income she determines. However, upon the son's death, the State Department of Children and Families will receive reimbursement from the trust assets up to the amount of medical assistance that they paid on the son's behalf during his lifetime. Any remaining trust assets will then be distributed to the son's heirs at law. The son's mother executed a disclaimer as to her contingent remainder interest in the trust.

To keep the son on Medicaid and fund the special needs trust with the IRA assets, the mother and legal guardian sought to transfer her son's share, as 1/4 beneficiary of his father's IRA to an IRA benefitting the special needs trust authorized by the state court. As part of this process the mother sought a private letter ruling from the Internal Revenue Service to establish two things. The first was the transfer of the father's IRA to the special needs trust would not be considered a transfer under I.R.C. § 691(a)(2) and would therefore be disregarded for Federal income purposes.

The second was that the mother as trustee could use her son's life expectancy to calculate the annual RMDs required under I.R.C. § 401(a)(9).

1. Private Letter Ruling 1: Transfer of IRA to Trust

The IRS begins the analysis of this question with an examination of whether or not the transfer from the IRA to an IRA for the benefit of the special needs trust qualifies as a taxable transfer. I.R.C. § 691(a)(1) provides that all items of gross income that are not properly includible in a prior period shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the

decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

I.R.C. § 691(a)(2) goes on to state that if a right described in § 691(a)(1) is received under the circumstances described in that section then the fair market value of that right shall be included in the gross income of the estate or person receiving it. For the purposes of this section, a "transfer" does not include the transmission at death to the estate of the decedent or a transfer to a person who has a right to receive it through bequest, devise, or inheritance.

Generally, the distribution to a beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions is gross income in respect of the decedent under I.R.C. § 691(a)(1) and is includible in the gross income of the beneficiary for the taxable year the distribution is received.[35] However, the rules are different when dealing with a grantor trust.

I.R.C. § 677(a) specifies that a grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse. Futhermore, if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes.[36] As such, a transfer of the grantor's assets to the trust is not recognized as a sale or disposition for federal income tax purposes.[37]

Based on this analysis, the Internal Revenue Service determined that the special needs trust was a grantor trust all of which would be treated as owned by the son under I.R.C. §§ 671 and 677(a). Therefore they determined that the transfer of the son's share of his father's IRA to

[35] Rev. Rul. 92-47, 1992-1 C.B. 198.

[36] Rev. Rul. 85-13, 1985-1 C.B. 184.

[37] Id.

the special needs trust was not a sale or disposition for the purposes of I.R.C. § 691(a)(2) and was not includible for federal income tax purposes.

2. Private Letter Ruling 2: Life Expectancy for Annual Distributions

The private letter ruling then moves on to analyze whose life expectancy should be used in calculating annual distributions from the IRA. The beginning point is that a trust will, in general, not be considered qualified unless the plan provides that the entire interest of each employee (i) will be distributed to such employee not later than the required beginning date, or (ii) will be distributed, beginning not later than the required beginning date, over the life of such employee or over the lives of such employee and a designated beneficiary or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary.[38] In general, if a portion of the interest of a deceased IRA holder is payable to, or for the benefit of, a designated beneficiary, such portion will be distributed beginning not later than one year after the date of the deceased's death and distributed over the life of the beneficiary (or a period not extending beyond the life expectancy of the beneficiary).[39] The designated beneficiary is defined as any individual designated as a beneficiary by the employee.[40]

The private letter ruling next examines the rules that apply if the IRA of a deceased IRA holder is divided into separate accounts for the purposes of I.R.C. § 401(a)(9).[41] These rules establish that if separate accounts are established under an IRA and the beneficiaries of one account differ from the beneficiaries of another account then the accounts are not aggregated with other accounts to determine whether they satisfy I.R.C. § 401(a)(9). This applies only as long as the separate accounts are established no later than the last day of the year following the calendar year of the IRA holder's death. These separate accounts must have a separate accounting maintained for each that includes all post-death investments, gains and losses, contributions and forfeitures for the period prior to the establishment of the separate accounts.[42]

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[38] I.R.C. § 401(a)(9)(A).

[39] I.R.C. § 401(a)(9)(B)(iii).

[40] I.R.C. § 401(a)(9)(E).

[41] *See* 2004-26 I.R.B. 1082, 1098 (June 28, 2004).

[42] Final Regulations § 1.401(a)(9)-8, Q&A-3.

After analyzing these requirements, the Internal Revenue Service determined that the "separate account" requirements of section 1.401(a)(9)-8 of the "Final" regulations, Q&As 2 had been met for the years after the father's death. Additionally, the Service determined that under the facts that the trust was intended to qualify as a special needs trust, and that the Service believed that it was appropriate to calculate the annual RMDs required under I.R.C. § 401(a)(9) by using the son's life expectancy.

3. Key Facts in this Case

There are two sets of facts in this case that facilitated a favorable ruling by the IRS. The first of these is that the required minimum distributions were made from the IRA to the son's guardian on his behalf. These required minimum distributions must be made by certain dates as required by the IRC. If the beneficiary fails to take the first RMD by that date will be an automatic election to default to the five-year rule.

The second important set of facts in this case is that the mother, as the son's guardian and trustee of the special needs trust, disclaimed her contingent remainder interest in the special needs trust. As one of the son's heirs at law she would otherwise have a contingent remainder interest under the special needs trust. However, she is also the trustee of that trust. Under the grantor trust rules, this situation may have prevented the trust from qualifying as a grantor trust because she would have been an adverse party. In this case, without the mother's disclaimer it is possible that the trust would not have qualified as a grantor trust. Without this qualification, the trustee to trustee transfer from the IRA to the trust would not have been possible. The only solution in this case would have been to liquidate the IRA, pay all the income tax, and place the remaining proceeds into the special needs trust.

4. What You should take away from Private Letter Ruling 200620025

Private letter rulings cannot be cited as precedent but only as an indication of the IRS's position on the particular question. You must pay very close attention to your deadlines for making distributions and filing any disclaimers. Do not anticipate that the IRA custodian will cooperate with you. Securing the cooperation of the IRA custodian or transferring the account to a custodian that will cooperate will be important.

B. Private Letter Ruling 201116005[43]

The facts of Private Letter Ruling 201116005 are as follows: The terms of the trust provide that *X* is the sole beneficiary of the trust during *X*'s lifetime. The trustee shall apply so much of the net income of the trust as trustee deems beneficial for the use of *X* taking into consideration the best interest and welfare of *X*. *If* the income from the trust, together with any other income and resources possessed by *X*, including all governmental benefits, is insufficient to provide for *X*'s benefit, trustee is authorized to invade principal. In general, however, the trustee may not invade the principal if such act will serve to deny, discontinue, reduce, or eliminate any government entitlement or payment which *X* would otherwise receive. Upon *X*'s death, any remaining principal and undistributed income of the trust shall be distributed to the State as reimbursement for assistance provided during *X*'s lifetime. After reimbursement to the State, all remaining principal and undistributed income will be distributed to *X*'s issue or, if there are no issue, to *X*'s siblings, then to their issue by representation. The facts of the private letter ruling do not disclose who is serving as trustee of the trust and the ruling does not include any discussion as to what makes the trust a "grantor" trust for income tax purposes.

The IRS begins its analysis with a discussion of I.R.C. § 691(a)(1). Although the ruling does not mention whether this is an "inherited" IRA or the beneficiary's own IRA, the reference to Section 691(a)(1), income in respect of a decedent (IRD), indicates that the ruling is addressing an inherited IRA. As in Private Letter Ruling 200620025, the IRS cites Revenue Ruling 86-13[44] and concludes that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. Therefore, the trust, as represented in the private letter ruling, will be treated as owned by *X* and the transfer of *X*'s share of the IRA to the trust is not a gift by *X* and will not be treated as a sale or disposition for federal income tax purposes.

C. Private Letter Ruling 201117042[45]

Although the IRS has issued favorable rulings on the transfer of an inherited IRA into a first-party SNT, the same cannot be said for a transfer of the SNT beneficiary's own IRA. In

[43] See Exhibit F.

[44] Rev. Rul. 85-13, 1985-1 C.B. 184

[45] See Exhibit H.

Private Letter Ruling 201117042[46], the IRS stated that "an individual retirement account cannot be set up and maintained in the name of a trust." Any transfer of an IRA to a trust should be treated as a taxable distribution by the financial institution making the transfer. The facts of Private Letter Ruling 201117042 are as follows: the taxpayer, a person with muscular dystrophy, filed a petition to the state court to create a first-party special needs trust for his own benefit. The taxpayer's only asset to be funded into the first-party SNT was his own IRA. The taxpayer signed documents that he thought transferred his IRA into his SNT. Instead, the financial institution transferred the taxpayer's IRA into a non-IRA account and issued a 1099 reporting a fully taxable distribution. The 60-day rollover period lapsed and the taxpayer requested a private letter ruling for additional time to transfer the funds from a non-IRA account to an IRA account and for the IRA to be titled in the name of the first-party SNT.

Although the taxpayer prevailed on the waiver of the 60-day rollover requirement, the IRS refused to favorably rule on the taxpayer's request to transfer his own IRA to a first-party SNT. The ruling does not discuss or mention whether the SNT established by the taxpayer was a grantor trust. The IRS concluded that the financial institution correctly issued a 1099 treating the transfer of the IRA as a fully taxable distribution.

D. Retirement Accounts, Payback Claim, and Taxes

Any distribution from the IRA will generate income tax. Whether the payment by the special needs trust of the State's Medicaid claim creates a corresponding deduction (as medical expenses) to the trust is an open question. As a general rule, the medical and dental expenses of a **decedent** that are paid by the estate or trust are not **deductible** in computing the estate's or trust's taxable **income**.[47]

Medical expenses are deductible only by the taxpayer who paid them (and only in the tax year in which they were paid). In addition, expenses incurred by a taxpayer for his medical care but paid after his death out of his estate aren't among the allowable income tax deductions in respect of a decedent. However, medical expenses are treated as paid by the taxpayer at the time

[46] Priv. Ltr. Rul. 201117042 (Apr. 29, 2011).
[47] IRS Pub. No. 559 (2005), p.19.

they were *incurred* if they are paid out of the deceased taxpayer's estate during the one-year period beginning with the day after the date of taxpayer's death.[48]

Medical expenses are "incurred" for this purpose in the year the medical services are rendered. If the services were rendered in a year for which a return has already been filed, an amended return must be filed for that earlier year. However, no credit or refund of tax will be allowed for any tax year for which the normal statutory period for filing a claim has expired.

> **Example:** A, who filed his return on a calendar year basis, died on June 1, Year 2, after having incurred $8,000 in medical expenses. $5,000 of that amount was incurred during Year 1 and the balance of $3,000 was incurred in Year 2. The decedent had filed his Year 1 income tax return on April 15, Year 2. His executor paid off the entire $8,000 liability in August Year 2. The decedent's executor may then file an amended return for Year 1 claiming the $5,000 medical expenses as a deduction thus securing a refund resulting from the increase in the decedent's Year 1 deductions. The $3,000 of expenses incurred in Year 2 may be deducted on the decedent's final return.

If the conditions discussed above are not satisfied, the medical expenses cannot be deducted on the deceased taxpayer's income tax return.

Until we have precedent for this situation, the trustee must make certain he or she retains enough cash to pay any income tax due from the receipt of the IRA distribution. Additional complication will occur if there is not enough money to pay the State Medicaid claim and any income tax due from the IRA distribution. Every fiduciary who pays any inferior debt due from the person or estate for whom he acts before he pays the taxes due the U.S. is personally liable.[49] Thus, an executor was personally liable for decedent's unpaid federal **income taxes** where he exhausted assets of the estate by making mortgage payments on decedent's jointly-held residence, paying state **income** taxes, and debts to general creditors.

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[48] Reg. Sec. 1.213-1(d)(1).

[49] 31 U.S.C. § 3713(b).

EXHIBIT A
Single Life Expectancy Table for Inherited IRAs

AGE	RMD	AGE	RMD	AGE	RMD	AGE	RMD	AGE	4.9
20	63.0	38	45.6	56	28.7	74	14.1	92	4.3
21	62.1	39	44.6	57	27.9	75	13.4	93	4.1
22	61.1	40	43.6	58	27.0	76	12.7	94	4.0
23	60.1	41	42.7	59	26.1	77	12.1	95	3.8
24	59.1	42	41.7	60	25.2	78	11.4	96	3.6
25	58.2	43	40.7	61	24.4	79	10.8	97	3.4
26	57.2	44	39.8	62	23.5	80	10.2	98	3.1
27	56.2	45	38.8	63	22.7	81	9.7	99	2.9
28	56.2	46	37.9	64	21.8	82	9.1	100	2.7
29	55.3	47	37.0	65	21.0	83	8.6	101	2.5
30	54.3	48	36.0	66	20.2	84	8.1	102	2.3
31	53.3	49	35.1	67	19.4	85	7.6	103	2.1
32	52.4	50	34.2	68	18.6	86	7.1	104	2.0
33	51.4	51	33.3	69	17.8	87	6.7	105	1.9
34	50.4	52	32.3	70	17.0	88	6.3	106	1.7
35	49.4	53	31.4	71	16.3	89	5.9	107	1.5
36	48.5	54	30.5	72	15.5	90	5.5	108	1.4
37	47.5	55	29.6	73	14.8	91	5.2	109	1.2
								110	1.1
								111	1.0

EXHIBIT B
Sample Conduit Trust Language
Sample 1

To the extent any trust hereunder is the beneficiary of a Retirement Account (as hereinafter defined) my Trustee shall draw the benefits from the Retirement Account in amounts sufficient to meet the minimum distribution requirements of IRC Section 401(a)(9) and the regulations thereunder (the "Required Minimum Distribution"). Notwithstanding any provision of the trust to the contrary, the Required Minimum Distribution shall be paid to or applied for the benefit of the person or persons then entitled to receive or have the benefit of the income from such trust, or if there is more than one income beneficiary, my Trustee shall make such distribution to such income beneficiaries in the proportion in which they are beneficiaries or if no proportion is designated in equal shares to such beneficiaries. "Retirement Account" means a plan qualified under IRC Section 401, or an individual retirement arrangement under IRC Section 408, or a Roth IRA under IRC Section 408A, or a tax-sheltered annuity under IRC Section 403 or any other benefit subject to the distribution rules of IRC Section 401(a)(9), or the corresponding provisions of any subsequent federal tax law. It is my intention that this trust qualify as a "conduit trust" under IRC Section 401(a)(9) so that the trust beneficiaries shall be considered designated beneficiaries for purposes of the minimum distribution rules, and that distributions may therefore be taken over the trust beneficiary's life expectancy (or the life expectancy of the oldest trust beneficiary). The Retirement Accounts shall not be subject to the claims of any creditor of my estate and they shall not be applied to the payment of my debts, taxes or other claims or charges against my estate unless and until all other assets available for such purposes have been exhausted, and even then only to the minimum extent that would be required under applicable law in the absence of any specific provision on this subject in this my Trust.

Sample 2

Special Provisions Relating to Retirement Account Benefits. Notwithstanding anything to the contrary contained in this Trust Agreement, if any trust established under this ARTICLE – or if a beneficiary of any trust established under this ARTICLE ---is the beneficiary of any qualified retirement plan or individual retirement account or annuity (a "Retirement Account") subject to the Internal Revenue Service Code section 401(a)(9) or comparable provisions (the "Minimum Distribution Rules"), the Trustee shall hold and administer the Retirement Account assets as provided in paragraph -- of this ARTICLE --.

Retirement Account Benefits. If any child or descendant of a deceased child survives me and is (or his or her trustee is) the beneficiary of a Retirement Account, the Trustee shall, immediately after my death and as of the time of my death, establish the separate trusts under paragraph -- of ARTICLE -- and promptly comply with the time deadline requirements of the Minimum Distribution Rules. The following are the rules relating to certain critical time deadlines at the time of the establishment of this Trust Agreement, however, even though such actions may not be required by law to be performed until a later date, it is my desire that the Trustee perform the actions listed in subparagraphs 1 and 2 below as soon as possible after my death and well in advance of September 30 of the year following the year of my death:

1. No later than September 30 of the year after the year of my death ("the beneficiary designation deadline"), notify the Administrator or Custodian of the Retirement Account of the names, addresses and social security numbers of the designated beneficiaries of the Retirement Account and their Trustees;

2. No later than October 31 of the year after the year of my death, give a copy of this Trust Agreement to the Administrator or Custodian of the Retirement Account;

3. The Trustees of the separate trusts created hereunder shall:

(a) by December 31 of the year after the year of my death, receive from the Retirement Account custodian the assets constituting the separate IRA account established for the trust beneficiary;

(b) with the trustees of any other trusts receiving IRA benefits, direct the Custodian of my Retirement Account to allocate all post-death investment gains and losses, distributions and forfeitures, for the period up to the creation of the Separate Accounts described above, on a pro rata basis in a manner intended to be reasonable and consistent among the several Separate Accounts;

(c) annually withdraw from each Separate Account no less than the amount required under the Minimum Distribution Rules for such year, plus such additional amount or amounts as the Trustee deems advisable in its sole discretion;

(d) distribute directly to the beneficiary of each such separate trust, each withdrawal from a Retirement Account (whether or not such withdrawal is required under the Minimum Distribution Rules) in the same year the trustee receives the distribution from the Retirement Account, if and to the extent necessary to enable the Retirement Account to use the beneficiary's life expectancy under the Minimum Distribution Rules without considering the identity or life expectancy of any other beneficiary (whether current or future, vested or contingent) of the trust, and hold and administer the remainder of the Separate Account according to the terms established in this Trust for separate trusts (except as modified by this paragraph).

(e) classify as income each such withdrawal and distribution for trust accounting and income tax purposes, notwithstanding other provisions of this Trust Agreement granting to the trustee the discretion to allocate receipts and disbursements between income and principal;

(f) If the Trustee deems it necessary or advisable, the trustee may establish reserves for payment of expenses attributable to the separate trusts, so long as such reserves are established and funded by September 30 of the year after the year of my death and provided that such actions do not disqualify the status of the separate trust as a conduit trust for purposes of the Minimum Distribution Rules. The Trustee may also deduct any expenses relating to the administration of the Individual Retirement Account (but not other expenses attributable to the trust) prior to distributing any withdrawal to the beneficiary, provided that

such deduction does not disqualify the status of the separate trust as a conduit trust for purposes of the Minimum Distribution Rules.

Exhibit C

DESIGNATION OF BENEFICIARY

A. Primary Beneficiary.

I hereby designate as my Primary Beneficiary, to receive 100% of the Death Benefits, my spouse _____, if my spouse survives me.

B. Contingent Beneficiary in Case of Disclaimer

If my spouse survives me, but disclaims the Death Benefit (or part of it), I hereby designate as my Contingent Beneficiary, to receive that part of the Death Benefit so disclaimed by my spouse, the Trustee (or the Trustee's successors in trust) of the Family Trust established under the _____ Living Trust dated October 30, 2000.

C. Contingent Beneficiary in Case of Death.

1. If my spouse does not survive me, the Plan Custodian shall allocate the Account as follows: ½ share for my child, _____; and ½ share to my child _____.

The share allocated to _____ shall be paid to the person named as Trustee (or the Trustee's successor in trust) of the _____ subtrust created under the _____ Living Trust dated October 30, 2000. The share allocated to my child, _____ shall be paid to the person named as Trustee (or the Trustee's successor in trust) of the _____ subtrust created under the _____ Living Trust dated October 30, 2000.

If _____ is deceased, his share shall be paid to his descendants, by representation. If _____ is deceased, her share shall be paid to her descendants, by representation. Each share allocated to a deceased child shall be further subdivided into sub-shares among the descendants of that deceased child, by representation and shall be paid to the Trustee (or the Trustee's successors in trust) of each separate trust established at my death for a descendant of such child under the _____ Living Trust dated October 30, 2000. The Plan Custodian shall partition the plan assets as set out above as soon after my death as possible but no later than December 31 of the year after the year of my death to the maximum extent such division is permitted by law to occur without causing a deemed distribution of the Account. The Plan Custodian shall allocate all post-death investment gains and losses, distributions and forfeitures, for the period up to the creation of the Separate Accounts described above, on a pro rata basis in a manner intended to be reasonable and consistent among the several Separate Accounts. Each such share and sub-share shall constitute a Separate Account (within the meaning of Section 401(a)(9) of the Internal Revenue Code and regulations thereunder) payable to a different beneficiary, namely, the trustee of the separate trust for the primary benefit of the child or descendant for whom such

share or sub-share is allocated. At the time I am signing this document I have two (2) children, namely, _____ (Born: _____), and _____ (Born: _____).

2. The newly created Separate Accounts shall be maintained as if each were a Separate Account in my name payable solely to the applicable beneficiary, and no beneficiary shall have any further interest in or claim to any Account Benefits other than the Separate Account representing his or her interest.

3. The Trustee of each beneficiary's Trust shall receive at least the minimum amount required by law to be distributed annually in order to defer the payment of income taxes but the Trustee is entitled to and may withdraw additional amounts (including all of such Separate Account) for the benefit of the beneficiary or to effect a custodial transfer of the account, if such a transfer is permitted by law without causing a deemed distribution of the Account. The Trustee, subject to the limitations of the Trust, may manage such Separate Account and name one or more beneficiaries of such Account.

4. The Plan Custodian may conclusively rely upon the certification of the Trustee of my Trust as to the proper payees and the Plan Custodian shall be fully released and discharged from any and all liability for payments in reliance upon such certification.

Exhibit D

SAMPLE
DESIGNATION OF BENEFICIARY
FOR IRAS ONLY

A. Participant Information.

Name: _____ Date of Birth: _____
Street Address: _____
Telephone Number: _____ Social Security Number:_____
Martial Status: _____

B. Account Information.

Account Number: _____

I hereby revoke all prior all prior beneficiary designations and designate the following beneficiaries for my account:

C. Primary Beneficiary.

If she survives me, I hereby designate my spouse, _____, as my Primary Beneficiary, to receive 100% of the Death Benefits associated with this account.

_____'s current address is: _____
_____'s Date of Birth is: _____
_____'s Social Security Number is:_____

D. Contingent Beneficiary in Case of Disclaimer.

If my spouse survives me, but disclaims the Death Benefit (or part of it), I hereby designate as my Contingent Beneficiary, to receive that part of the Death Benefit so disclaimed by my spouse,

Forty Percent (40%) to the Trustee of the Testamentary Trust created for the benefit of _____ as according to Section 3.2 of the Last Will and Testament of _____ dated April 13, 2005.

Sixty Percent (60%) to the Trustee of the Testamentary Trust created for the benefit of _____ according to Section 3.2 of the Last Will and Testament of _____ dated April 13, 2005.

E. Contingent Beneficiary in Case of Death.

1. If my spouse does not survive me, the Plan Custodian shall allocate the Account as follows:

Forty Percent (40%) to the Trustee of the Testamentary Trust created for the benefit of _____ according to Section 3.2 of the Last Will and Testament of _____ dated April 13, 2005.

Sixty Percent (60%) to the Trustee of the Testamentary Trust created for the benefit of _____ according to Section 3.2 of the Last Will and Testament of _____ dated April 13, 2005.

_____'s current address is: _____
_____'s Date of Birth is: _____
_____'s Social Security Number is:_____

_____'s current address is: _____
_____'s Date of Birth is: _____
_____'s Social Security Number is:_____

If any child for whom a share is created does not survive me, his or her share shall be distributed by representation. Each share allocated to a deceased child shall be further subdivided into sub-shares among the descendants of that deceased child, by representation.

2. The Plan Custodian shall partition the plan assets as set out above as soon after my death as possible but no later than December 31 of the year after the year of my death to the maximum extent such division is permitted by law to occur without causing a deemed distribution of the Account. The Plan Custodian shall allocate all post-death investment gains and losses, distributions and forfeitures, for the period up to the creation of the Separate Accounts described above, on a pro rata basis in a manner intended to be reasonable and consistent among the several Separate Accounts. Each such share and sub-share shall constitute a Separate Account (within the meaning of Section 401(a)(9) of the Internal Revenue Code and regulations thereunder) payable to a different beneficiary, namely, the trustee of the separate trust for the primary benefit of the child or descendant for whom such share or sub-share is allocated.

3. The newly created Separate Accounts shall be maintained as if each were a Separate Account in my name payable solely to the applicable beneficiary, and no beneficiary shall have any further interest in or claim to any Account Benefits other than the Separate Account representing his or her interest.

4. The Trustee of any beneficiary's Trust shall receive at least the minimum amount required by law to be distributed annually in order to defer the payment of income taxes but the Trustee is

entitled to and may withdraw additional amounts (including all of such Separate Account) for the benefit of the beneficiary or to effect a custodial transfer of the account, if such a transfer is permitted by law without causing a deemed distribution of the Account. The Trustee, subject to the limitations of the Trust, may manage such Separate Account and name one or more beneficiaries of such Account.

5. The Plan Custodian may conclusively rely upon the certification of the Trustee of my Trust as to the proper payees and the Plan Custodian shall be fully released and discharged from any and all liability for payments in reliance upon such certification.

F. Participant Signature.

Signature: _____ Date: _____

EXHIBIT E

Respect of Decedents

PLR 200620025 - Section 691 - Recipients of Income in Respect of Decedents

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

FEB 21 2006

UICs:
691.00-00
691.01-00
401.06-00
401.06-02

LEGEND:

Taxpayer A :
Taxpayer B :
Taxpayer C :
Bank N :
Court T :
State W :
Date 1 :
Date 2 :
Date 3 :
Date 4 :
Date 5 :
Trust T :
IRA X :
IRA Y :

Dear [redacted data]:

This is in response to the [redacted data] request for letter ruling submitted by your authorized representative on your behalf, as supplemented by correspondence dated[redacted data] , [redacted data], and [redacted data], [redacted data], and [redacted data],[redacted data] in which your authorized representative requests letter rulings under sections 401(a)(9) and 691(a)(2) of the Internal Revenue Code ("Code"). The following facts and representations support your ruling request.

Taxpayer A died on Date 1, [redacted data] at age 69 prior to attaining his required beginning date as that term is defined in Code section 401(a)(9)(C). Taxpayer B is one of his four surviving sons. At his death, Taxpayer A owned an individual retirement account (IRA X) with Bank N of which his four sons were equal named beneficiaries pursuant to a beneficiary designation dated Date 2, [redacted data]. Taxpayer B is disabled, and his mother, Taxpayer C, is his legal guardian ("Guardian"). Taxpayer B is eligible to receive Medicaid and other public benefits, and it is represented that such eligibility could lapse if he directly owned a portion of IRA X.

The IRA X custodian set aside the shares of Taxpayer B's three brothers in separate sub-IRAs (separate accounts) for their benefit on or about Date 4, [redacted data] . The shares of Taxpayer B's three brothers were not distributed as part of said set aside. Taxpayer B's share has not been distributed from IRA X except for required minimum distribution(s) (RMD(s)) made to the Guardian since calendar year [redacted data] on his behalf. It has been represented that the subdivision of IRA X into three separate IRAs (shares) for Taxpayer B's three brothers (with Taxpayer B's share remaining in IRA X) was done on an equal, pro rata, basis.

A State W court, Court T, a court of competent jurisdiction, acting on a petition by the Guardian, issued an order dated Date 3, [redacted data], authorizing the creation of a trust for the Taxpayer's benefit, intended to qualify as a "special needs trust" ("Trust T") under state and federal law. It is represented that if Trust T qualifies as a "special needs trust" the trust assets will not be considered as assets of Taxpayer B in determining his eligibility to receive public benefits.

The terms of Trust T provide that the Guardian is the trustee and Taxpayer B is the sole beneficiary of Trust T during his lifetime. The Guardian may distribute to or apply for the benefit of Taxpayer B so much of the net income and principal of Trust T as appears advisable in her sole discretion. The Guardian may accumulate any or

all of Trust T income; income not distributed in the current year shall be added to principal. Upon Taxpayer B's death, the balance of Trust T shall be distributed to the State W Department of Children and Families to the extent necessary to satisfy the total medical assistance paid for Taxpayer B's benefit by that department during his life. The remaining balance shall be distributed to Taxpayer B's heirs at law under the State W law of intenstacy (in a manner and proportion provided in Trust T). The Guardian has disclaimed her contingent remainder interest (as one of Taxpayer B's heirs at law) in Trust T by means of a disclaimer dated Date 5, [redacted data]. For purposes of this letter ruling, the Service will assume that said disclaimer falls within Code section 2518.

The Guardian proposes to transfer, with state court approval, Taxpayer B's share, as 1/4, beneficiary thereof, of IRA X to an IRA benefiting Trust T and the beneficiary(ies) thereof. It has been represented that, pursuant to said transfer, IRA X shall be re-rifled IRA Y.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1. That the transfer of IRA X (as described above) to Trust T will be disregarded for Federal income purposes, and will not be considered a transfer under Code section 691(a)(2); and

2. the trustee of Trust T, Guardian, may calculate the annual distributions required under Code section 401(a)(9) (made applicable to IRAs X and Y 'pursuant to Code section 408(a)(6)), to be made to Trust T from IRA Y using Taxpayer B's life expectancy.

With respect to your first letter ruling request, section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent (IRD) which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent)shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or ((2) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a)(2) provides that if a right, described in § 691(a)(1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by rein of the death of the decedent or by bequest, devise, or inheritance from the decedent.

Revenue Ruling 92-47, 1992-1 C.B. 198, holds that a distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions, is IRD under Code section 691(a)(1) that is includable in the gross income of the beneficiary for the taxable year the distribution is received.

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 677(a) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under Code section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Rev. Rul. 85-13, 1985-1 C.B. 184, concludes that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. Therefore, a transfer of the grantor's assets to the trust is not recognized as a sale or disposition for federal income tax purposes.

Based solely on the facts and representations submitted, we conclude, with respect to your first ruling request, that Trust T is currently a grantor trust all of Which is treated as owned by Taxpayer B under §§ 671 and 677(a). Therefore, the transfer of Taxpayer B's share of IRA X to Trust T is not a saic or disposition of said share of the IRA for federal income tax purposes and is not a transfer for purposes of § 691 (a)(2).

With respect to your second ruling request, Code section 401 (a)(9)(A) provides, in general, that a trust will not be considered qualified unless the plan provides that the entire interest of each employee-

(i) will be distributed to such employee not later than the required beginning date, or
(ii) will be distributed, beginning not later than the required beginning date, over the life of such employee or over

the lives of such employee and a designated beneficiary or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary.

Code section 408(a)(6) provides that, under regulations prescribed by the Secretary, rules similar to the rules of section 401(a)(9) and the incidental death benefit requirements of section 401(a) shall apply to the distribution of the entire interest of an individual for whose benefit the trust is maintained.

Code § 401(a)(9)(B)(ii) provides, in general, that ira plan participant (IRA holder) dies before the distribution of his interest has begun in accordance with such (A)(ii) (prior to his required bo beginning date), then his entire interest must be distributed within 5 years of his death.

Code § 401(a)(9)(B)(iii) provides, in general, that if any portion of the interest of a deceased plan participant (IRA holder) is payable to (or for the benefit of a designated beneficiary), such portion will be distributed beginning not later than 1 year after the date of the deceased's death (or a later date as prescribed by the Secretary under Regulations) in accordance with regulations over the life of the designated beneficiary (or a period not extending beyond the life expectancy of the beneficiary).

Code § 401(a)(9)(C) provides, in relevant part, that, for purposes of this paragraph, the term "required beginning date" means April 1 of the calendar year following the calendar year in which the employee attains age 70 1/2.

Code section 401(a)(9)(E) defines "designated beneficiary" as any individual designated as a beneficiary by the employee (IRA holder).

With further respect to your second ruling request, "Final" Income Tax Regulations under Code sections 401(a)(9) and 408(a)(6) were published in the Federal Register at 67 Federal Register 18987-19028 (April 17, 2002), and in the Internal Revenue Bulletin at 2002-19 I.R.B. 852 (May 13, 2002). The Preamble to the "Final" Regulations, in relevant part, provide that the regulations apply for determining required minimum distributions for calendar years beginning after January 1, 2003. For determining required distributions for calendar year [redacted data], taxpayers may rely on the 1987 proposed regulations, the 2001 proposed regulations, or the "Final" Regulations..

In addition, the "Final" Regulations have been modified in part (See 2004-26 I.R.B. 1082, 1098 (June 28, 2004)). The modification to the "Final" Regulations may also be relied upon with respect to required distributions for the [redacted data] calendar year.

Section 1.401(a)(9)-3 of the "Final" regulations, Q&A-3(a) provides, in general, that, with respect to the life expectancy exception to the S-year rule described in Code § 401(a)(9)(B)(iii), and in A-1, distributions are required to begin to a non-spouse beneficiary on or before the end of the calendar year immediately following the calendar year in which the employee died. This rule also applies if another individual is a designated beneficiary in addition to the employee's (IRA holder's) surviving spouse.

Section 1.401(a)(9)-3 of the "Final" regulations, Q&A-4(a), provides, in relevant part, that in the absence of a plan provision to the contrary, with respect to an individual who dies prior to reaching his required beginning date, if said individual has designated a beneficiary, distributions from his plan or IRA are to be made in accordance with the life expectancy rule of Code sections 401(a)(9)(B(iii) and (iv).

Section 1.401(a)(9)-5 of the "Final" regulations, Q&A-5(b), provides, in general, that if an employee dies before his required beginning date, in order to satisfy the requirements of Code § 401(a)(9)(B)(iii) or (iv) and the life expectancy rule described in A-1 of § 1.401(a)(9)-3, the applicable distribution period for distribution calendar years after the distribution calendar year containing the employee's date of death is determined in accordance with paragraph (c) of this A- 5.

Section 1.401(a)(9)-5 of the "Final" regulations, Q&A-5(c)(1), provides, in general, that, with respect to a non-spouse beneficiary, the applicable distribution period measured by the beneficiary's remaining life expectancy is determined using the beneficiary's age as of the beneficiary's birthday in the calendar year immediately following the calendar year of the employee's death. In subsequent calendar years, the applicable distribution period is reduced by one for each calendar year that has elapsed after tile calendar year immediately following the calendar year of the employee's death.

Section 1.401(a)(9)-4 of the "Final" regulations, Q&A-1, provides, in relevant part, that a designated beneficiary is an individual who is designated as a beneficiary under a plan either by the terms of the plan or by an affirmative election by the employee. Q&A-1 further provides that a person who takes under a will or otherwise under applicable state law will not be a designated beneficiary unless that individual also takes under a plan.

Section 1.401(a)(9)-5 of the "Final" regulations, Q&A-7(a) provides, in summary, that except as otherwise provided in paragraph (c) of this A-7 (not pertinent to this ruling request), if more than one individual is designated as a beneficiary with respect to an employee as of the applicable date for determining the designated beneficiary, the named beneficiary with the shortest life expectancy will be the designated beneficiary for purposes of determining the applicable distribution period.

Section 1.401(a)(9)-4 of the "Final" regulations, Q&A-4, provides, in relevant part, that in order to be a designated beneficiary, an individual must be a beneficiary as of the date of the employee's death. Generally, an employee's designated beneficiary will be determined based on the beneficiaries designated as of the date of death who remain beneficiaries as of September 30 of the calendar year following the calendar year of death. Q&A-4 further provides, that "consequently, any person who was a beneficiary as of the date of the employee's (IRA holder's)

death, but is not a beneficiary as of that September 30 (e.g. because the person receives the entire benefit to which he is entitled before that September 30) is not taken into account in determining the distribution period for required minimum distributions after the employee's death. Accordingly, if a person disclaims entitlement to the employee's benefit pursuant to a disclaimer that satisfies section 2518 by that September 30 thereby allowing other beneficiaries to receive the benefit in lieu of that person, the disclaiming person is not taken into account in determining the person's designated beneficiary".

Section 1.401(a)(9)-8 of the "Final" regulations, Qs&As-2 and 3 provide the rules that apply if the IRA of a deceased IRA holder is divided into separate accounts for purposes of Code section 401(a)(9).

Section 1.401(a)(9)-8 of the "Final" regulations, Q&A-2(a)(2), provides that if an employee's (IRA holder's) benefit in a defined contribution plan is divided into separate accounts and the beneficiaries with respect to one separate account differ from the beneficiaries with respect to the other separate accounts of the employee under the plan, for years subsequent to the calendar year containing the date as of which the separate accounts were established, or date of death if later, such separate account under the plan is not aggregated with the other separate accounts under the plan in order to determine whether the distributions from such separate account under the plan satisfy section 401(a)(9). However, the applicable distribution period for each such separate account is determined disregarding the other beneficiaries only if the separate account is established on a date no later than the last day of the year following the calendar year of the employee's (IRA holder's) death.

Section 1.401(a)(9)-8 of the "Final" regulations, Q&A-3, defines separate accounts for purposes of Code section 401(a)(9), aa separate portions of an employee's benefit reflecting the separate interests of the employee's beneficiaries under the plan as of the date of the employee's death for which separate accounting is maintained. The separate accounting must allocate all post-death investments, gains and losses, contributions, and forfeitures for the period prior to the establishment of the separate accounts on a pro rata basis in a reasonable and consistent manner among the separate accounts.

Section 1.401(a)(9)-9, of the "Final" Regulations, Q&A-1, sets forth the "Single Life Table" used to compute the life expectancy of an individual.

As previously noted, taxpayers must compute minimum required distributions for calendar years beginning with calendar year [redacted data] in accordance with the "Final" regulations referenced above.

With respect to your second ruling request, based on the facts contained herein, the Service believes that the "separate ac trot" requirements of section 1.401(a)(9)-8 of the "Final" regulations, Qs&As-2, have been met for years subsequent to calendar year [redacted data]. Additionally, based on the facts contained herein, the representation that Trust T is intended to qualify as a "special needs trust" under state and federal law to preserve Taxpayer B's eligibility to receive public benefits, and with reference to the conclusion reached on the ffls ruling regarding the status of Trust T as a grantor trust, the Service believes that it is appropriate to calculate the annual distributions required under Code section 401(a)(9) (made applicable to IRAs X and Y pursuant to Code section 408(a)(6), made to Trust T from IRA Y by using Taxpayer B's life expectancy.

Our conclusion to this second ruling request does not change even after Taxpayer B's share of Taxpayer A's IRA X is transferred, by means of a trustee to trustee transfer, to IRA Y, an IRA set up and maintained in the name of Taxpayer A to benefit Taxpayer B through Trust T.

Thus, with respect to your second ruling request, the Service concludes as follows:

> the trustee of Trust T, Guardian, may calculate the annual distributions required under Code section 401(a)(9) (made applicable to IRAs X and Y pursuant to Code section 408(a)(6)), to be made to Trust T from IRA Y by using Taxpayer B's life expectancy.

This ruling letter is based on the assumption that IRA X either has met, is meeting, or will meet the requirements of Code § 408(a) at all times relevant thereto. Furthermore, it assumes that IRA Y will also meet the requirements of Code section 408(a) at all times relevant thereto. It also assumes that Trust T is valid under the laws of State W as represented. Finally, it assumes that the disclaimer referenced hereto met the requirements of Code section 2518.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations, which may be applicable thereto.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The original of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you wish to inquire about this ruling, please contact [redacted data], Esquire (ID:[redacted data] -[redacted data])) at either [redacted data] - [redacted data] (Phone) or[redacted data] - [redacted data] (FAX). Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Frances V. Sloan, Manager,
Employee Plans Technical Group 3

EXHIBIT F

REV. RUL. 2002-20, 2002-17 I.R.B. 794 (4/29/2002)

Section 664.--Charitable Remainder Trusts

26 CFR 1.664-3: Charitable remainder unitrust.

Charitable remainder trusts; qualified charitable remainder unitrusts; recipient trusts. This ruling provides that, in three situations, a charitable remainder unitrust may pay the unitrust amounts to a second trust for the life of an invidual, who is financially disabled as defined in section 6511(h)(2)(A) of the Code. In each situation, the use of the unitrust amounts by the second trust is consistent with the manner in which the individual's own assets would be used, and the individual is, therefore, considered to have received the unitrust amounts directly from the charitable remainder unitrust for purposes of section 664(d)(2)(A).

Rev. Rul. 2002-20

ISSUE

May a trust qualify as a charitable remainder unitrust under section 664 of the Internal Revenue Code, if the unitrust amounts are paid to a separate trust for the life of an individual who is "financially disabled," as defined in section 6511(h)(2)(A)?

FACTS

An individual concurrently creates Trust *A*, a trust that otherwise qualifies as a charitable remainder unitrust, and a separate trust, Trust *B*. Under the governinginstrument of Trust *A*, annualunitrust amounts will be paid to Trust *B* for the life of *C*. *C* is an individual who is financially disabled, that is, *C* is unable to manage *C*'s own financial affairs by reason of a medically determinable physical or mental impairment that can be expected to result in death or that has lasted or can be expected to last for a continuous period of not less than 12 months.

Situation 1. Under the governing instrument of Trust *B*, a designated portion of the amount it receives from Trust *A* will be paid to *C* each month. If, at any time in the sole judgment of the trustee, the monthly payment to *C* is insufficient to provide adequately for the care, support, and maintenance of *C*, or is insufficient for the needs of *C* for any reason, additional amounts will be paid as needed to or on behalf of *C* from Trust *B*. Upon *C*'s death, the balance remaining in Trust *B* will be distributed to *C*'s estate.

Situation 2. Under the governing instrument of Trust *B*, the trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of *C* in a manner that supplements but does not supplant any governmental benefits otherwise available to *C*. Upon *C*'s death, the balance remaining in Trust *B* will be distributed to *C*'s estate.

Situation 3. Under the governing instrument of Trust *B*, the trustee may make distributions of income and principal, as determined in the trustee's sole and absolute discretion, for the financial aid and best interests of *C* in a manner that supplements but does not supplant any governmental benefits otherwise available to *C*. Upon *C*'s death, the governing instrument requires the trustee to reimburse the state for the total costs of medical assistance provided to *C* under the state's Medicaid plan. *C* is given a testamentary general power of appointment over the balance remaining in Trust *B*. If *C* fails to exercise the power, the balance will be distributed, in equal shares, to *C*'s sister and to X, a charitable organization.

LAW AND ANALYSIS

A charitable remainder unitrust is a trust from which a unitrust amount is payable at least annually during its term with an irrevocable remainder interest held for the benefit of charity. Under section 664(d)(2)(A), the unitrust amount is a fixed percentage (not less than 5 percent and not more than 50 percent) of the net fair market value of the trust assets, valued annually. The unitrust amount is to be paid to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of the individual or individuals.

Section 1.664-3(a)(5)(i) of the Income Tax Regulations provides that the period for which the unitrust amount is payable begins with the first year of the charitable remainder trust and continues either for the life or lives of a named individual or individuals or for a term of years not to exceed 20 years. Only an individual or an organization described in section 170(c) may receive an amount for the life of an individual.

In general, a charitable remainder unitrust may pay unitrust amounts to a second trust only for a term of 20 years or less. In Situations 1, 2, and 3, the unitrust amounts are payable to Trust *B* for the life of *C*, not for a term of years. However, in each of these situations, the sole function of Trust *B* is to receive and administer the unitrust amounts for the benefit of *C*, who is unable to manage *C*'s own financial affairs by reason of a medically determinable mental or physical impairment. Upon *C*'s death, the assets remaining in Trust *B* will be distributed either to *C*'s estate or, after reimbursing the state for any Medicaid benefits provided to *C*, will be subject to *C*'s general power of appointment. In these situations, the use of the assets in Trust *B* during *C*'s life and at *C*'s death is consistent with the manner in which *C*'s own assets would be used. *C*, therefore, is considered to have received the unitrust amounts directly from Trust *A* for purposes of section 664(d)(2)(A). Accordingly, the term of Trust *A* may be for the life of *C* and is not limited to a term of years.

The same result would apply if Trust *A* were a charitable remainder annuity trust.

HOLDING

A trust may qualify as a charitable remainder unitrust under section 664 if the unitrust amounts will be paid for the life of a financially disabled individual to a separate trust that will administer these payments on behalf of that individual and, upon the individual's death, will distribute the remaining assets either to the individual's estate or, after reimbursing the state for any Medicaid benefits provided to the individual, subject to the individual's general power of appointment.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-270 (1976-2 C.B. 194) which addresses facts covered by *Situation 1*, is amplified and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jan Bennett Geier of the Office of Associate Chief Counsel (Passthroughs andSpecial Industries). For further information regarding this revenue ruling, contact Ms. Geier at (202) 622-7830 (not a toll-free call).

EXHIBIT G

PLR 201116005 - Section 677 - Income for Benefit of Grantor

Internal Revenue Service
Department of the Treasury
Washington, DC 20224

Number: 201116005
Release Date: 4/22/2011
Index Number: 677.00-00, 691.01-00
Third Party Communication: None
Date of Communication: Not Applicable
Person To Contact:
Telephone Number:
Refer Reply To: CC:PSI:B01 PLR-129484-10
Date: December 15, 2010

X =
A =
Trust =
D1 =
State =

Dear [redacted data]:

This letter responds to the letter dated April 5, 2010, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting a ruling under the Internal Revenue Code.

FACTS

The information submitted states that X is disabled and eligible to receive public benefits. X's father, A, died D1. A owned two individual retirement accounts (IRAs) of which X and X's siblings are the designated beneficiaries. X proposes to transfer X's share of the IRAs to a newly established IRA benefitting Trust and the beneficiaries thereof.

Trust is intended to be a special needs trust. The terms of Trust provide that X is the sole beneficiary of Trust during X's lifetime. The trustee shall apply so much of the net income of Trust for the use of X as the trustee in its sole discretion shall determine is beneficial to X taking into consideration the best interest and welfare of X. If the income from Trust, together with any other income and resources possessed by X, including all governmental benefits, is insufficient to provide for the benefit of X, in the sole opinion of the trustee of Trust, the trustee is authorized to invade the principal for X's benefit. In general, however, the trustee may not invade the principal if such act will serve to deny, discontinue, reduce, or eliminate any government entitlement or payment which X would otherwise receive. The trustee shall accumulate and add to principal any net income not so paid or applied. Upon X's death, any remaining principal and undistributed income of Trust shall be distributed to State as reimbursement for assistance provided during X's lifetime. After reimbursement to the State, all remaining principal and undistributed income will be distributed to X's issue or, if there are no issue, to X's siblings, then to their issue by representation.

LAW AND ANALYSIS

Section 691(a)(1) of the Code provides that the amount of all items of gross income in respect of a decedent (IRD) which are not properly includible in respect of the taxable period in which falls the date of the decedent's death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of: (A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent; (B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or (C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

Section 691(a)(2) provides that if a right, described in § 691(a)(1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest,

devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

Section 1.691(a)-4(a) of the Income Tax Regulations provides that if a right described in § 691(a)(1) is disposed of by gift, the fair market value of the right at the time of the gift must be included in the gross income of the donor.

Rev. Rul. 92-47, 1992-1 C.B. 198, holds that a distribution to the beneficiary of a decedent's IRA that equals the amount of the balance in the IRA at the decedent's death, less any nondeductible contributions, is IRD under § 691(a)(1) that is includable in the gross income of the beneficiary for the taxable year the distribution is received.

Section 671 provides that where it is specified in subpart E of Part I of subchapter J that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against the tax of an individual.

Section 677(a) provides that the grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under § 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be (1) distributed to the grantor or the grantor's spouse; (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse.

Rev. Rul. 85-13, 1985-1 C.B. 184, concludes that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. A grantor's receipt of the corpus of a trust in exchange for an unsecured promissory note was treated as an unsecured borrowing of the trust corpus which caused the grantor to be treated as the owner of the trust under § 675(3). The transfer of the trust assets in exchange for the note was not recognized as a sale for federal income purposes.

CONCLUSIONS

Based solely on the facts and representations submitted, we conclude that Trust will be treated as owned by X under §§ 671 and 677(a). Therefore, assuming the transfer of X's share of the IRAs to the Trust is not a gift by X, such transfer will not be a sale or disposition for federal income tax purposes or a transfer for purposes of § 691(a)(2).

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, we express or imply no opinion under § 401(a)(9).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representatives.

Sincerely,
Faith P. Colson
Faith P. Colson
Senior Counsel, Branch 1 Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc:

EXHIBIT H

PLR 201117042 - Section 408 - Individual Retirement Accounts

201117042

COMMISSIONER
TAX EXEMPT AND GOVERNMENT ENTITIES DIVISION
DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

JAN 31 2011

Uniform Issue List: 408.03-00

LEGEND:

Taxpayer A:
Trustee B:
Company N:
Court T:
County U:
State W:
Date 1:
Date 2:
Date 3:
Date 4:
Date 5:
Date 6:
Date 7:
Month 1:
Trust T:
Amount U:
IRAX:

Dear [redacted data]:

This is in response to the July 1, 2009, request for letter ruling submitted by your authorized representative on your behalf, as supplemented by correspondence dated April 12, 2010, April 13, 2010, and May 14, 2010, in which your authorized representative requests a waiver of the 60 day rollover requirement contained in section 408(d)(3) of the Internal Revenue Code ("Code"). The following facts and representations support your ruling request.

Taxpayer A was born on Date 1, 1962 and thus is 47 years of age. Taxpayer A formerly held IRA X with Company N. Taxpayer A has been diagnosed as having muscular dystrophy, and has been determined to be disabled by the Social Security Administration. His mother, Trustee B, is his attorney in fact pursuant to a General Durable Power of Attorney dated Date 4, 2007. Taxpayer A is eligible to receive Medicaid and other public benefits.

A State W court, Court T, County U, a court of competent jurisdiction, acting on a petition by Taxpayer A, dated Date 2, 2007, issued an order, dated Date 2, 2007, authorizing the creation of a trust for the Taxpayer's benefit, intended to qualify as a "special needs trust" ("Trust T") under state and federal law.

The amount required to be placed into Trust T pursuant to the terms of the above-referenced Date 2, 2007 Court T order, as amended on Date 5, 2007, was Amount U, the balance of IRA X.

On or about Date 6, 2007, Taxpayer A and Trustee B signed paperwork with Company N authorizing the amounts then held in IRA X to be transferred from IRA X to an account set up in the name of Trust T. Taxpayer A and Trustee B signed said paperwork believing that the transferred amounts would continue to be held in an individual retirement account ("IRA"). On or about Date 7, 2007, Company N denied the request to set up an IRA in the name of Trust T. On or about Date 3, 2008, pursuant to a request by the financial advisor of Taxpayer A, Company N transferred the amounts then held in IRA X, Amount U, into an account set up in the name of Trust T. The financial advisor transfer request provided, in part, ".. .as ordered by the County U Court". On or about Date 3, 2008, Company N complied with that request. During Month 1, 2009, Company N issued a Form 1099 to Taxpayer A reflecting the Date 3, 2008 distribution from IRA X to an account set up in the name of Trust T because an IRA

cannot be set up and maintained in the name of a trust. This request for letter ruling was filed with the Internal Revenue Service ("Service") shortly thereafter.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1.That, pursuant to section 408(d)(3)(I) of the Internal Revenue Code, the 60-day rollover period found at section 408(d)(3)(A) of the Code applicable to the distribution made on or about Date 3, 2008, from IRA X is waived; and

2.that Taxpayer A, is granted a period not to exceed 60 days as measured from the date of this ruling letter to roll over an amount not to exceed Amount U into an IRA-

Section 408(d)(1) of the Code provides that, except as otherwise provided in section 408(d), any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72 of the Code.

Section 408(d)(3) of the Code defines, and provides the rules applicable to IRA rollovers. Section 408(d)(3)(A) of the Code provides that section 408(d)(1) of the Code does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the IRA is maintained if (i)the entire amount received (including money and any other property) is paid into an IRA for the benefit of such individual not later than the 60th day after the day on which the individual receives the payment or distribution; or (ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan (other than an IRA) for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to section 408(d)(3)).

Section 408(d)(3)(B) of the Code provides that section 408(d)(3) does not apply to any amount described in section 408(d)(3)(A)(i) received by an individual from an IRA if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in section 408(d)(3)(A)(i) from an IRA which was not includible in gross income because of the application of section 408(d)(3).

Section 408(d)(3)(D) of the Code provides a similar 60-day rollover period for partial rollovers.

Code section 408(d)(3)(E) provides, in summary, that this paragraph does not apply to any amount required to be distributed in accordance with subsection (a)(6) or (b)(3)(Code section 401(a)(9) required distributions).

Section 408(d)(3)(I) of the Code provides that the Secretary may waive the 60-day requirement under sections 408(d)(3)(A) and 408(d)(3)(D) of the Code where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. Only distributions that occurred after December 31, 2001, are eligible for the waiver under section 408(d)(3)(I) of the Code.

Revenue Procedure 2003-16, 2003-4 I.R.B. 359, (January 27, 2003), provides that in determining whether to grant a waiver of the 60-day rollover requirement pursuant to section 408(d)(3)(I), the Service will consider all relevant facts and circumstances, including: (1) errors committed by a financial institution; (2) inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error, (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred.

The facts submitted in support of this ruling request indicate that, during calendar year 2008, Amount U was transferred from IRA X into an account set up and maintained in the name of Trust T. Company N, the financial institution which accomplished the transfer, correctly noted that an individual retirement account cannot be set up and maintained in the name of a trust, and appropriately issued a federal Form 1099 treating the Date 3, 2008 transfer as a taxable distribution.

The facts submitted in support of this ruling request indicate that Taxpayer A's financial advisor, acting on behalf of Taxpayer A, and on behalf of Trustee B, the trustee of Trust T, requested the IRA X distribution. The Service notes that although the financial advisor's instruction to Company N was based on a Court T order, a taxable event did occur as a result of the transfer and as a result of the actions of Taxpayer A's financial advisor.

Thus, under the facts outlined above, the Service, pursuant to Code section 408(d)(3)(I), waives the 60-day rollover period applicable to the Date 3, 2008 distribution from IRA X. Therefore, with respect to your ruling requests, the Service concludes as follows:

1.That, pursuant to section 408(d)(3)(I) of the Internal Revenue Code, the 60-day rollover period found at section 408(d)(3)(A) of the Code applicable to the distribution made on or about Date 3, 2008, from IRA X is waived; and

2.that Taxpayer A is granted a period not to exceed 60 days as measured from the date of this ruling letter to roll over an amount not to exceed Amount U into an IRA.

This ruling letter is based on the assumption that IRA X either has met, is meeting, or will meet the requirements of Code section 408(a) at all times relevant thereto.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations, which may be applicable thereto.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The original of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you wish to inquire about this ruling, please contact me [redacted data].

Sincerely yours,

Frances V. Sloan, Manager,
Employee Plans Technical Group 3

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose

IRAs, Qualified Plans, Pensions, etc. with the SNT Named as Beneficiary

Bradley J. Frigon, CELA,CAP, JD, LLM
Law Offices of Bradley J. Frigon
6500 S. Quebec St. Suite 330
Englewood, CO 80111
720-200-4025
www.bjflaw.com

IRA accounts and Third Party SNTs

- If you are an elder law attorney – this entire discussion is about Required Minimum Distributions (RMDs).
- If you are a trust and estate lawyer, do not confuse taxable income to a trust or a beneficiary with income for SSI purposes. They are not the same.

Overview of Retirement Assets

- Income in Respect of a Decedent (IRD)
  - No step-up in basis under IRC § 1014.
  - Taxed to beneficiary as ordinary income when distributed from a retirement plan.
- Most heavily taxed assets, with double or triple taxation possible: Income, Estate, GST.

Required Beginning Date For Account Owner

- A participant must begin taking Required Minimum Distributions (RMDs) from his retirement assets by his Required Beginning Date or "RBD." The RBD is April 1st of the calendar year AFTER the calendar year in which the participant reaches age 70½.

Required Beginning Date

Bob is born on 6/30/1942. Bob turns 70 on 6/30/2012
Bob turns 70 ½ on 12/30/2012. Bob's RBD is 4/01/2013

Jane is born 7/1/1942. Jane turns 70 on 7/1/2012
Jane turns age 70 ½ on 1/1/2013. RBD is 4/1/2014

Required Lifetime Distributions After Age 70 ½

- General Rules – Unless you are married to someone who is more than ten years younger than you, there is one – and only one- table of numbers that tells you the portion of your IRA, 403(b) plan or qualified retirement plan that must be distributed to you each year after you attain the age of 70 ½.

Required Lifetime Distributions After Age 70 ½ (cont.)

- The only exception to this table is if (1) you are married to a person who is more than ten years younger than you and (2) she or he is the only beneficiary on the account. RMDS are based on the actual joint life expectancy of you and your younger spouse.

Required Lifetime Distributions After Age 70 ½ (cont.)

- Two Simple Steps:
  - **Step 1**: Find out the value of your investments in your retirement plan account on the last day of the preceding year.
  - **Step 2**: Multiply the value of your investments by the factor in the table that is next to the age that you will be at the end of this year. This is the minimum amount that you must receive this year to avoid a 50% penalty.

Required Lifetime Distributions After Age 70 ½ (cont.)

- Example:
  - George had $1,000,000 in his only IRA at the beginning of the year. He will be age 80 at the end of this year. He must receive at least $53,500 during the year to avoid a 50% penalty.

Overview of Retirement Assets

- Uniform Table

Age	RMD	Age	RMD	Age	RMD	Age	RMD	Age	RMD

Overview of Retirement Assets

- Selected Excerpt from Joint Table

Ages	50	51	52	53	54	55	56	57	58

Distributions at Death

- Inherited IRA (Beneficiary Other Than Spouse)
- Death After RBD
  - Option 1:
    - Distributions based on longer of beneficiary's life expectancy *or* the life expectancy of the participant as of the year of death;
    - Must take first distribution by December 31st of year after participant's death;
    - Use Single Life Expectancy Table, or
  - Option 2
    - Five-Year Rule.

Calculating RMDs for a Beneficiary

- If the beneficiary is 58 when the participant dies, the factor to determine the beneficiary's RMD is 27. The following year, the beneficiary factor to calculate RMD is 26 (27-1). If the participant was 50 when he died, the beneficiary could use a factor of 34.2 (the participant's factor) for calculating RMDs.

Overview of Retirement Assets

- Single Life Expectancy Table for Inherited IRAs

Age	RMD	Age	RMD	Age	RMD	Age	RMD	Age	RMD

Overview of Retirement Assets

- Single Life Expectancy Table for Inherited IRAs

Age	RMD	Age	RMD	Age	RMD	Age	RMD	Age	RMD

Distributions at Death

- No Designated Beneficiary Named?
  - No beneficiary designated by participant
  - Estate
  - Charity Distributions at Death
  - Non-Qualified Trust

No Designated Beneficiary

- Five year rule applies:
  - Under the five year rule, the entire balance of the retirement plan must be distributed to the beneficiary no later than December 31 of the calendar year five years from the participant's death. Not required to make distributions equally over the five year period.

Multiple Beneficiaries and the Separate Account Rule

- If you can divide each beneficiary's share into a separate account then each beneficiary can use own life expectancy. You must contact the custodian and physically divide the accounts.
- Must be completed by December 31 of the year following the participant's death.

Separate Account Rule and Trusts

- Note the separate account rule does NOT apply to multiple beneficiaries who take their interest through a trust.
- Several PLRs ruled that if a trust was to be divided into sub-trusts for each beneficiary after the settlor's death, every sub-trust must calculate RMDs based upon oldest beneficiary of the original trust.

Example –Separate Account Rule

- Upon the death of the IRA Owner, the IRA shall pass to the IRA Account Owner's RLT established on(date), to be divided into three equal shares and allocated to A subtrust – B subtrust and C subtrust.
- The foregoing language probably does not create separate accounts. As a result oldest beneficiary life expectancy must be used.

Example –Separate Account Rule (cont.)

- The IRA shall be divided into three separate accounts that are hereby designated respectively to the A subtrust, B subtrust and C subtrust arising at the IRA Owner's death under the IRA Account Owner's RLT.
  - The difference between the two examples is subtle but critical. Under the first designation, the entire plan goes to the Account Owner's RLT and the division occurs afterwards. Under the second example, the plan assets pass directly to the individual subtrusts.

DB and RMD Rules for Trusts

- First Step: If a participant names a qualified trust as the beneficiary of an eligible retirement plan, then the trust beneficiary will be treated as the beneficiary of the account for purposes of determining whether there is a designated beneficiary and who it is.
- Second Step: Once the trust qualifies as a qualified trust and a beneficiary is identified as a designated beneficiary, then you must determine the applicable measuring life.

Qualified Designated Beneficiary Trust

- To be a Qualified Trust, the Trust must:
  - Be valid under state law.
  - Be irrevocable or becomes irrevocable by participant's date of death. (Third Party Stand Alone SNT problem).
  - All beneficiaries are identifiable under the terms of the trust.
  - A copy of the trust document is provided to the plan administrator or IRA custodian by no later than October 31 of the calendar year after the death of the participant.

Step Two – Identifying Measuring Life

- If the trust qualifies as a "qualified trust", the beneficiaries of the trust(and not the trust itself) will be treated as a designated beneficiary. In other words, the IRS will look through the trust directly at the beneficiary to determine if the participant has a designated beneficiary.
- Step two requires that you identify the beneficiary or beneficiaries of the trust that are used as the measuring life to calculate RMDs. The selection of the correct beneficiary or beneficiaries will depend on whether the trust is classified as a **"Conduit Trust"** or an **"Accumulation Trust."**

Conduit Trust

- Neither the Code nor the Regulations use the term "Conduit trust" or "See Through Trust". Both terms have been adopted as a common usage name for a trust under which the trustee has no power to accumulate retirement plan distributions in the trust.
- With a conduit trust, the trustee is required, by the terms of the governing instrument, to distribute the RMDs to the beneficiaries of the trust on a current basis so that no amounts distributed from the qualified plan or IRA during the current beneficiaries' lifetimes are accumulated for the benefit of subsequent beneficiaries. The trustee has no power to hold or retain in trust *any* plan distribution made during the lifetime of the conduit trust beneficiary

Conduit Trust (cont.)

- The IRS considers the conduit beneficiary as the sole beneficiary of the trust. Remainder beneficiaries are disregarded for purposes of calculating RMDs even if remainder beneficiaries are not DBs.

Conduit Trust (cont.)

- Example: A creates a trust for the benefit of his wife. The terms of the trust provide that wife must receive all income. The Trustee has discretion to distribute principal for wife's health, education and support. Upon wife's death all property passes to A's siblings. If a sibling predeceases then passes to charity.
- Since Conduit trust only look at wife's life expectancy to determine RMD's. Do not need to look at A's siblings or charity.

Accumulation Trust

- With an accumulation trust, the trustee has discretion to accumulate or distribute income to the beneficiary.
- With an accumulation trust, you must look at life expectancy of all current and successor beneficiaries to determine the measuring life for RMD purposes.
  - A special needs, or a discretionary support trust are examples of an accumulation trust.

Accumulation Language

- Consistent with the guidelines, limitations and purposes of this Trust, our Trustee shall distribute to or for the benefit of <Name of Beneficiary> as much of the income and principal, in our Trustee's sole and exclusive discretion, as is necessary or advisable for his health, education, maintenance, support, wellbeing, and happiness. Such distributions may be made from the income and principal of this Trust. Any undistributed income shall be added to principal. The Trustee shall make distributions without regard to the effect that such distributions may have upon the interest, if any, of the contingent beneficiaries.

Current and Successor Beneficiaries

- With an accumulation trust a successor beneficiary may not be excluded if he or she has any right (including a contingent right) to a plan interest "beyond being a mere potential successor" to the interest of another beneficiary upon that other beneficiary's death.
- The "pool" of Trust Beneficiaries is determined on the account owner's death, subject to certain post-mortem planning completed prior to the September 30 Determination Date.

Examples – Accumulation Trust

- A creates a trust that provides discretionary income and principal to son B (B is A's only child) for B's lifetime. Upon B's death, the remaining principal and income is paid to a class of beneficiaries in equal shares consisting of B's issue. If B does not have issue that survive, then the balance of trust passes to A's heirs at law.
- Example 1 – When A dies, A is survived by B and B has two children age 25 and 22. Identify the measuring life.
- Example 2, When A dies, B does not have any children. A' s heirs at law (other than B) consist of his siblings ages 75 and 80. Will your answer change if B has a child 5 years after A dies?

Example - Accumulation Trust Power to Appoint to Charity

- A creates a trust that provides discretionary income and principal to son B. Upon B's death, the remaining principal and income is paid to a class of beneficiaries consisting of B's issue and any charity as appointed by B in his will. Since B's power to appoint includes a power to appoint to a non-individual, the trust would not have a DB for RMD purposes.
- If the terms of the trust did not provide a power of appointment to charity, then B's life expectancy would be used because all of B's issue must be younger in age.
- How would you fix the power of appointment problem?

Calculating RMDs for an Accumulation Trust

- Father establishes a SNT for his special needs son A and designates the SNT as the primary beneficiary of his IRA. The father's IRA has a $1,000,000 balance at the time of his death. Upon A's death, the balance of the assets of the SNT go to A's siblings, B and C. A is 20, B is 40, and C is 45 at their father's death. In this case, the RMD rules require A, B, and C to be considered as beneficiaries. C's life expectancy is used to determine RMDs because C is the oldest.

Calculating RMDs for an Accumulation Trust (con't)

- The factor for C at age 45 is 38.8. Using a factor of 38.8 creates a RMD for the initial year of the trust of $25,773.20 ($1,000,000÷ 38.8). If RMDs are based on A's life expectancy, a factor of 63 is used. A factor of 63 decreases RMDs to $15,873.02 ($1,000,000 ÷ 63). By naming C as a remainder beneficiary, the RMD increased by $9,900.18.

Evaluating the Impact of RMDs

- If the beneficiary has considerable expenses and the trustee will use all RMDs to pay for the beneficiary's care or other needs, then an increase of RMDS is probably not significant.
- If beneficiary does not have significant expenses and RMDs will accumulate in trust, then trust will pay income tax on accumulated income.). Although similar tax rates (15%, 25%, 28%, 33%, and 35%) apply to both individuals and trusts, the tax brackets for a trust are more compact than for an individual. In 2015, a trust with taxable income over $12,150 is taxed at a 39.6%-rate bracket. In contrast, an unmarried individual must have taxable income over $400,000 to reach the 39.6% rate bracket for 2015 (or taxable income of $450,000 for married individuals filing joint returns.
- Falling under the 5 year rule would be a costly mistake for most beneficiaries.

Options to Consider

- Drafting
- Charitable Remainder Trust
- Disclaimers
- Decanting
- Reformation

Drafting

- When all of the beneficiaries of an accumulation trust are relatively close in age, RMDs will not be significantly impacted. Nonetheless, the SNT attorney should understand that payments from the inherited IRA to the Third Party SNT after the death of the account owner will be taxable income to the SNT. If it is likely the SNT will distribute all current income to or for the benefit of the SNT beneficiary, then there will be minimal income tax consequence to the trust.

Charitable Remainder Trust Planning

- Another option that should be considered is a lump-sum distribution of all or a portion of a taxable retirement account to a *charitable remainder trust* (CRT) that may first benefit the surviving spouse, then other beneficiaries (such as children), and then a charity. The principal income tax advantage is that a CRT is a tax-exempt trust, so there will be no income tax liability when it receives the income from the retirement plan account.

Charitable Remainder Trust Planning (cont.)

- The IRS addressed the issue on whether the terms of the CRT making distribution to another trust must be limited to a term of 20 years or the life of the beneficiary in Revenue Ruling 2002-20. Revenue Ruling 2002-20 provides that CRT distributions can be made to a second trust, for the life of an individual who is "financially disabled" under three situations. The ruling states that an individual shall be determined to be "financially disabled" if the individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuance period of not less than 12 months.

Disclaimers of Retirement Benefits

- A disclaimer is the refusal to accept a gift or inheritance. Federal tax law recognizes that a person cannot be forced to accept a gift or inheritance. Therefore a disclaimer itself (provided it meets the requirements of § 2518) is not treated as a taxable transfer. For tax purposes, the person making the disclaimer never accepted the property in the first place, he never owned it and therefore could not have given it away. For SSI/Medicaid purposes, a disclaimer will be treated as a transfer of assets.

Disclaimers of Retirement Benefits (cont.)

- Disclaimers of inherited retirement benefits can be very useful in post mortem planning even when dealing with special needs planning. However, the order of who disclaims and when will be critical. For example, you will create a period of ineligibility or be forced to create a first party pay-back trust if you named the beneficiary with a disability as your primary beneficiary and then disclaimed. Even if your contingent beneficiary was a special needs trust, a disclaimer by the disabled beneficiary to his or her special needs trust would create a period of ineligibility.

Disclaimers of Retirement Benefits (cont.)

- On the other side of this issue, a disclaimer is an effective means to eliminate an older beneficiary, power of appointment or charitable beneficiary that impacts RMDs for the special needs beneficiary. Acceptance of required minimum distributions ("RMDs") by the primary beneficiary of retirement accounts following the participant's death prevents the beneficiary from disclaiming both the RMDs and the income attributable to the RMDs. However, the beneficiary may validly disclaim the balance of the retirement accounts.

Decanting

- Decanting may be an option to remove an older beneficiary or a nondesignated beneficiary provided the impermissible or problem beneficiaries are removed by the September 30th deadline. Currently, there are no rulings by the IRS on whether decanting is an effective means to correct an existing trust with older or nondesignated beneficiaries. Additionally, it is unclear whether a state Medicaid office would take the position that a decanting of an existing Third Party SNT constitutes a transfer without consideration by the SNT beneficiary.

Reformation

- Private Letter Rulings have discussed a court's modification of a trust or beneficiary designation made by the settlor of a trust or the IRA owner with varying results, depending on the specific facts of the case. In PLR 200742026, the IRS refused to recognize a retroactive beneficiary designation made by the court when the decedent failed to name a contingent beneficiary (although there was no disagreement that the decedent intended to name one) after a new IRA custodian began administering the IRA.

Example – Surviving Spouse Distribution Options at Age 80

- A – **Her Own IRA**, established with contributions she made during her working career.
- B – **A rollover IRA**, funded after her husband's death with a distribution from his 401(k) plan.
- C - **A stretch IRA** – Her sister's IRA

Example – Surviving Spouse Distribution Options at Age 80 (con't)

- D –**Trust #1 – Her deceased husband's IRA is payable to a standard accumulation trust**, treated as a stretch IRA payable to an **accumulation trust** (where the required distributions are based on the age of the oldest beneficiary of the trust.

Example – Surviving Spouse Distribution Options at Age 80 (con't)

- E – **Trust #2 – Her deceased husband's IRA is payable to a similar trust, but the trust requires all retirement plan distributions to be made to Ms. Widow (Conduit Trust)**. This provision permits a look-through trust to be treated as a conduit trust.

Example – Surviving Spouse Distribution Options at Age 80 (con't)

- CRT – **Charitable Remainder Trust** – After his death, her husband's fourth IRA was distributed in a lump sum to a tax-exempt CRT that will annually distribute 5% of its assets to Ms. Widow for the rest of her life, then to her husband's 50-year old child from his first marriage for the rest of the child's life, and then upon the child's death will be distributed to a charity.

Example – Surviving Spouse Distribution Options at Age 80 (cont.)

- At age 80, Ms. Widow began receiving distributions from several IRAs, including the IRAs of her older husband and her older sister (both of whom had died in the preceding year). Although the life expectancy of a 80 year old is 10 years (i.e., to age 90), Ms. Widow in fact lived to age 92. Whereas the law requires two IRAs (IRAs C and D) to be empty by age 90, amounts could still be in the other IRAs at that age. The minimum amounts required to be distributed from each of the six IRAs are listed in the table.

Age	IRAs A&B (Widow's Own Rollover)	IRAs C&D (Accumulation)	IRA E (Conduit)	IRA CRT
80	5.35%	9.80%	9.80%	5.00%
81	5.59%	10.87%	10.31%	5.00%
82	5.85%	12.20%	10.99%	5.00%
83	6.14%	13.89%	11.63%	5.00%
84	6.46%	16.13%	12.35%	5.00%
85	6.76%	19.23%	13.16%	5.00%

Age	IRAs A&B (Widow's Own Rollover)	IRAs C&D (Accumulation)	IRA E (Conduit)	IRA CRT
86	7.10%	23.81%	14.08%	5.00%
87	7.47%	31.25%	14.93%	5.00%
88	7.88%	45.45%	15.87%	5.00%
89	8.33%	83.33%	16.95%	5.00%
90	8.78%	100.00%	18.18%	5.00%
91	9.26%	Empty	19.23%	5.00%
92	9.81%	Empty	20.41%	5.00%

Required Payments After Ms. Widow's Death

- **IRA CRT**: The charitable remainder unitrust (CRUT) will commence payments to the next beneficiaries (children) upon the death of the surviving spouse. A CRUT must annually distribute at least 5% of the value of its assets, recalculated annually. With a two generation trust (parent and then child), the parties will likely select the 5% amount to be able to get the minimum 10% charitable deduction necessary for the trust to qualify as a CRT.

Legal Authority for the Various Payout Rules in Exhibits E, F and G

- **IRA A**: Reg. Sec. 1.401(a)(9)-5, Q&A 4 and Reg. Sec. 1.401(a)(9)-9, Table A-2
- **IRA B**: Same, and also Secs. 402(c)(9) and 408(d)(3)(C)(ii)(II).
- **IRA C**: Sec. 408(d)(3)(c) and Reg. Sec. 1.401(a)(9)-5, Q&A 5(a)(1)(I).
- **IRA D**: Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 1
- **IRA E**: Reg. Sec. 1.401(a)(9)-5, Q&A 7(c)(3), Example 2. The life expectancies are from Reg. Sec. 1.401(a)(9)-9, Table A.'

First Party Trusts and Inherited Retirement Accounts

- Many means tested Medicaid programs require the individual applicant to have less than $2,000 of non-exempt resources.
- Ownership of an IRA (through an inheritance or because the Medicaid applicant owned his/her own IRA account) will financially disqualify the individual from receiving means tested benefits.
- Regulations under I.R.C Section 408 require ownership of an IRA to be individual.

First Party Trusts and Inherited Retirement Accounts PLR 200620025

Taxpayer A died at age 68 while owning an Individual Retirement Account (IRA). This IRA named his four sons as beneficiaries through a beneficiary designation. One of his sons was a minor and receiving Medicaid benefits. The mother obtained an order from the State Court authorizing the creation of a special needs trust for her son's benefit. The trust authorized by the court was a First Party Special Needs Trust with a payback provision. The mother was designated as trustee, and the son as the sole lifetime beneficiary of the trust. During the son's life, the trustee may distribute to or apply for his benefit as much of the net income of the trust as advisable in the trustee's sole discretion. Income not distributed must be added to principal.

Continuation of Facts

Upon the son's death, the State Department of Children and Families will receive reimbursement from the trust assets up to the amount of medical assistance that they paid on the son's behalf during his lifetime. Any remaining trust assets will then be distributed to the son's heirs at law. The minor son's heirs at law consists of his mother and siblings. The son's mother executed a timely disclaimer as to her contingent remainder interest in the trust.

Tax Questions

- Whether the transfer of the father's IRA to the son's SNT causes an immediate recognition of income under IRC Code Sec. 691(a)(2)?
- Whether annual RMDs from the SNT may be calculated using the son's life expectancy?

Holding of PLR 200620025

- Under Rev. Rul. 85-13, a grantor trust and the grantor of the trust are treated as the same taxpayer for federal income tax purposes;
- A transfer of a grantor's assets to a grantor trust is disregarded for federal income tax purposes;
- Use son's life expectancy for purposes of calculating RMDs.

Other Key Points to Remember

- This is an Inherited IRA. It is not the special needs beneficiary's own IRA;
- PLRs cannot be cited as precedent;
- Disclose on tax return;
- Uncooperative IRA custodians;
- Don't wait to disclaim or reform your trust.

Private Letter Ruling 201116005

- Private Letter Ruling 201116005 are as follows: The terms of the trust provide that *X* is the sole beneficiary of the trust during *X*'s lifetime. The trustee shall apply so much of the net income of the trust as trustee deems beneficial for the use of *X* taking into consideration the best interest and welfare of *X*.

Private Letter Ruling 201116005 (cont.)

- *If* the income from the trust, together with any other income and resources possessed by *X*, including all governmental benefits, is insufficient to provide for *X*'s benefit, trustee is authorized to invade principal. In general, however, the trustee may not invade the principal if such act will serve to deny, discontinue, reduce, or eliminate any government entitlement or payment which *X* would otherwise receive.

Private Letter Ruling 201116005 (cont.)

- Upon *X*'s death, any remaining principal and undistributed income of the trust shall be distributed to the State as reimbursement for assistance provided during *X*'s lifetime. After reimbursement to the State, all remaining principal and undistributed income will be distributed to *X*'s issue or, if there are no issue, to *X*'s siblings, then to their issue by representation. The facts of the private letter ruling do not disclose who is serving as trustee of the trust and the ruling does not include any discussion as to what makes the trust a "grantor" trust for income tax purposes.

Private Letter Ruling 201116005 (cont.)

- The IRS begins its analysis with a discussion of I.R.C. § 691(a)(1). Although the ruling does not mention whether this is an "inherited" IRA or the beneficiary's own IRA, the reference to Section 691(a)(1), income in respect of a decedent (IRD), indicates that the ruling is addressing an inherited IRA. As in Private Letter Ruling 200620025, the IRS cites Revenue Ruling 86-13[1] and concludes that if a grantor is treated as the owner of a trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. Therefore, the trust, as represented in the private letter ruling, will be treated as owned by *X* and the transfer of *X*'s share of the IRA to the trust is not a gift by *X* and will not be treated as a sale or disposition for federal income tax purposes

Private Letter Ruling 201117042

- Although the IRS has issued favorable rulings on the transfer of an inherited IRA into a First Party SNT, the same cannot be said for a transfer of the SNT beneficiary's own IRA. In Private Letter Ruling 201117042, the IRS stated that "an individual retirement account cannot be set up and maintained in the name of a trust." Any transfer of an IRA to a trust should be treated as a taxable distribution by the financial institution making the transfer. The facts of Private Letter Ruling 201117042 are as follows: the taxpayer, a person with muscular dystrophy, filed a petition to the state court to create a First Party Special Needs Trust for his own benefit.

Private Letter Ruling 201117042 (cont.)

- The taxpayer's only asset to be funded into the First Party SNT was his own IRA. The taxpayer signed documents that he thought transferred his IRA into his SNT. Instead, the financial institution transferred the taxpayer's IRA into a non-IRA account and issued a 1099 reporting a fully taxable distribution. The 60-day rollover period lapsed and the taxpayer requested a private letter ruling for additional time to transfer the funds from a non-IRA account to an IRA account and for the IRA to be titled in the name of the First Party SNT.

Private Letter Ruling 201117042 (cont.)

- Although the taxpayer prevailed on the waiver of the 60-day rollover requirement, the IRS refused to favorably rule on the taxpayer's request to transfer his own IRA to a First Party SNT. The ruling does not discuss or mention whether the SNT established by the taxpayer was a grantor trust. The IRS concluded that the financial institution correctly issued a 1099 treating the transfer of the IRA as a fully taxable distribution.

Payback Claims and Taxes

- The withdrawal of money from a retirement account will generate income tax;
- Paying a state Medicaid claim after the beneficiary dies is probably not a deductible expense to the trust for income tax purposes;
- Make sure trustee holds back enough money to pay income tax or elects sufficient withholding;
- Personal liability for trustee?

PRE-CONFERENCE:

TAX INTENSIVE

Wednesday, October 14, 2015
3:15 P.M. – 4:15 P.M.

The Devil and the Details: Employment-Related Tax Issues and Special Needs Trusts

Presenter:
Katherine Barr
Attorney at Law, Sirote & Permutt, P.C.
Birmingham, AL

- Materials
- Exhibits A-C

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THE DEVIL AND THE DETAILS: EMPLOYMENT –RELATED TAX ISSUES AND SPECIAL NEEDS TRUSTS

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I. **INTRODUCTION.** -- One of the most common expenditures for a Special Needs Trust during the lifetime of a beneficiary is paying caregivers. This may range from paying a parent who is unable to work outside the home because of a child's multiple needs, or it may involve hiring caregivers through an agency or directly. The duties may range from companionship and limited personal assistance to skilled care from a medically trained attendant. Personal caregivers may not have any particular training, qualifications, license or special training, and except in the case of a parent caregiver, should be vetted to avoid exposing the child and family to exploitation, embezzlement, physical and mental abuse and other criminal activity. Indeed, some caregivers may be identified from answering a newspaper ad or by word of mouth from acquaintances. This program will address some of the technical issues to be handled when a trust hires a caregiver for a beneficiary with a disability.

II. **PAYING A PARENT AS A CAREGIVER.** -- Most states allow family members to serve as compensated caregivers without compromising the government benefits of a special needs trust beneficiary. Some states, e.g., Mississippi, nevertheless, do not allow family members to be compensated, regardless of the degree of special training the caregiver has or the age of the beneficiary. Whether the person with a disability is an adult or a minor, the payment to a family member caregiver should not be larger than what a non-family member would receive. Excess salary might be considered as a gift or transfer that causes a loss of eligibility for government benefits.

A. **Paying a Parent to Care for an Adult Child.** – Compared to the issues that exist when a parent is paid to care for a minor child, paying a parent to care for an adult child (generally age 18 or older) is much simpler. Because the child is an adult the issue of compensating a parent for his duty of support generally goes away. Other issues, however, are important. Consider the following:

1. The adult child, age 25, has a brain injury and numerous other physical disabilities from meningitis contracted by a medical mishap. The child requires 24/7 care and cannot be left alone. She lives with her parents in a home specially designed for her needs. The parents are often up during

the night assisting the child with procedures that she needs every 2-3 hours. She requires therapy at home and Mom has been trained by her daughter's physical therapist to work with her every day on exercises to help her maintain her mobility. Mom worked in a high school lunchroom, but chose to terminate her employment to stay home and care for her daughter. Step-father does not work and receives Social Security Disability Income (SSDI) because of congestive heart failure. Mom performs the majority of her daughter's personal care, which includes giving medications, injections, bathing and dressing, catheterizing, taking her daughter to appointments and being available to assist her when she is using a walker or a wheelchair. Mom is basically on-duty all but a few hours a day, 7 days a week. How should the caregiver agreement for Mom be structured?

2. Although not having to be concerned about the deeming rules since the child is an adult, the Trustee still has to work out a reasonable arrangement with Mom as caregiver. The trust must last for the beneficiary's lifetime, so expenses are carefully monitored. Paying Mom for being on-call at least 22 hours a day, 7 days a week is extreme and cannot be justified. On occasion, other family members sit with the beneficiary and allow Mom to take care of other business and housekeeping tasks. Looking at Mom not charging for some of the general duties in maintaining a household for her daughter, and caring for her daughter without pay for a portion of time, Mom agreed to be paid by the Trustee for a 40 hour work week. Researching the customary and usual rate for what a non-family member caregiver would charge for the services Mom performs, then lowering that rate by a small amount, was used to determine the basis for paying Mom under the caregiver agreement. The many duties she assists with, including a list of all skilled care performed, were described in an exhibit to the contract. The corporate Trustee that serves with Mom as co-Trustee of the child's special needs trust, enlists the services of a payroll company to take care of all of the payroll taxes, withholding, worker's

compensation, and other bookkeeping requirements that this outline will discuss. The contract is reevaluated every year in terms of appropriate rate and duties.

B. **Paying a Parent to Care for a Minor Child.**

1. Deeming Issue Can Be a Problem. -- The most serious issue to consider in paying a parent of a minor child is often referred to as "circular deeming, " and it arises when the minor child applies for SSI, especially in a single-parent household where the parent stays home to care for the child. When a child under age 18 lives in the household of a parent, part of the income (whether earned or unearned) of the parent is deemed to the child.[1] If a special needs trust pays the parent for caring for the minor child in the parent's household, the wages count as the parent's income and are deemed back to the child. The trust proceeds paid to Mom count against the child's eligibility for SSI. Worse yet, this may be considered as *unearned* income, which counts dollar-for-dollar to reduce SSI.[2] This compares to *earned* income, of which only fifty percent (50%) is deemed. The circular deeming problem exists in distributions from both third-party and self-settled trusts.

2. Extraordinary Care vs. Regular Care; Legal Obligation of Support. -- The federal and state imposed parental obligation of care and support to a minor child causes additional concerns when paying a parent to care for a minor child. It is well established that a self-settled special needs trust cannot be used to discharge a parent's legal obligation to support a minor child. The Trustee should distinguish between "normal" care for a child and "extraordinary" care required by the child's disability. For a parent to

[1] The deeming rules that apply when a child under age 18 is being evaluated for SSI are complex and will not be discussed in this outline.

[2] **Calef v. Barnhart**, 309 F.Supp.2d 425 (DC N.Y. 2004), held that payments from a special needs trust to a parent as care for a minor child with disabilities was unearned income. The case turned on the fact that the Court Order setting up the trust required $1,000 a month be paid to the mother since she could not work outside the home. Social Security determined that this $1,000 a month was unearned income. On appeal of this issue, Social Security stated that a stipend of this type is not a wage, and affirmed the decision, and all was deemed unearned income.

ask for compensation for typical care provided to a child, chances of having this distribution approved by a Court are slim. The case of **State v. Hammans**[3] concerned a d(4)(A) Trust established with personal injury proceeds by the minor child's parents, who cared for him 24/7. The Court required supervision of the d(4)(A) Trust, including annual accountings to be approved. Following the child's death, the state Medicaid Agency's claim greatly exceeded the balance of the Trust. The parents filed a Petition asking for administration fees for managing the Trust and fees for caring for the minor child. The Court approved the parents' Petition, resulting in the parents receiving nearly the entire balance of the Trust, with only a tiny amount passing to reimburse the state Medicaid Agency. The state argued that because the parents had not sought payment for care during their child's lifetime, they had provided care for him out of their love. On appeal, the decision was affirmed.[4]

It should be noted that SI 001120.201 F.2.c. of the POMS directs the Social Security employee to "consider whether compensation is being provided to a family member or if there is some other reason to question the reasonableness of the compensation" when a parent is being compensated for serving as a caregiver.

3. Solution to Resolving Dilemma. -- When a parent (or any caregiver, for that matter) is going to be compensated for being a caregiver, the agreement between the Trust and the parent should clearly define the non-typical services for which the parent is being compensated as compared to the typical care services that parents are expected to provide under state and federal law. As illustrated in the Personal Services Contract attached as **Exhibit A**, the explicit details of the non-typical care services should be listed. A properly-drafted caregiver agreement between the special needs trust and the parent/caregiver clearly setting out the duties resolves the

[3] **State v. Hammons**, 870 N.E.2d 1071 (Ind. App. Ct. 2007).
[4] **State v. Hammons**, id; but see **Hobbs v. Zenderman**, 542 F.Supp.2d 1220 (D.N.M 2008).

problem in most circumstances.

The care agreement should address such issues as liability, payroll taxes, worker's compensation and other expenses, as well as overtime payment, holidays and vacation. It should also specify required training of the caregiver (e.g. CPR, first aid, and tube feeding). It is preferable that a non-parent co-Trustee sign the agreement on behalf of the Trust rather than having a parent as Trustee of the special needs trust enter into a contract with himself as caregiver. Obviously, many conflict of interest issues arise in that scenario. To resolve this, it may be preferable to have the care agreement, or at least decisions about hiring and salary, approved by a Court to avoid any later allegations of impropriety. A Court ruling also helps to avoid an argument that the caregiver is breaching his fiduciary duty to the child with special needs.

III. **THE PERSONAL SERVICES CONTRACT. -- Exhibit A** to this outline contains a sample care agreement generously provided to the author by Reginald Turnbull, CELA of the firm of Turnbull and Stark, P.C., in Jefferson City, Missouri. Also attached as **Exhibit A-1** is a sample page to an agreement prepared by the author listing the detailed care provided by a parent to a particular child. For another sample of a Caregiver Employment Agreement, Begley & Canellos, Special Needs Trust Handbook, Appendix 9-2 (2015 – 2 Supplement). The caregiver employment agreement contained in the Special Needs Handbook contains a very comprehensive list of services for the person with a disability to be provided by the employee. These include, among others, descriptions of care in the following areas: transportation, shopping, laundry, insurance, medications, health assessment, securing health care, monitoring health care, assistance with all personal needs, shopping, cooking, providing social interaction and entertainment, arranging for outings and satisfaction of the child's spiritual, social or companionship needs. The sample agreement offers a long list of hands-on care services to be considered for inclusion. These include infection control precautions, seizure precautions, stroke and cardiac precautions, safety and fall precautions, arranging and supervising speech, occupational, physical, play and other types of therapy, and

supervising the use of assisted devices, such as a walker, scooter, braces, prostheses and lifts.

A properly drafted care services agreement will also clearly state the compensation arrangement, term of the agreement, specifics of tax withholding, and other legal terms important to applicable state laws and revision and interpretation of the Agreement. This should include how many hours and days a week the caregiver will work and whether the services vary on particular days such as weekends. The caregiver may need specific goods and supplies or equipment in order to perform the tasks specified, and the caregiver should obligate the Trustee to provide this. In addition, a written caregiver agreement should include the termination rights of the employer and caregiver.

An attorney drafting a Personal Services or Care Agreement contract should check state law for applicable statutes. Reg Turnbull has advised that Missouri has state statute, §208.213, Revised Statutes of Missouri, "Personal Care Contracts, Effect on Eligibility," which contains important provisions to ensure the validity and fairness of personal care agreement.

IV. **IS THE CAREGIVER AN "EMPLOYEE" OR AN "INDEPENDENT CONTRACTOR?"** -- The most common topic for discussion in preparation of a Personal Services Contract is whether the caregiver is being employed as an "employee" or an "independent contractor?" While employers (e.g., the Trustee of the special needs trust) generally prefer hiring a caregiver as an independent contractor, the reality is that the caregiver is actually an employee. *Money* magazine has summed it up as follows:

> "Put simply, independent contractors are cheaper for companies to hire. Employers do not have to offer them benefits like health insurance and 401ks, pay them overtime or give them paid days off. They don't have to pay into state unemployment insurance or worker's compensation funds on the contractor's behalf. And they don't have to cover the employer's share of their payroll taxes or withhold income taxes."[5]

A. **Comparison of Characteristics**. -- A brief comparison of the characteristics of

[5] *Money* magazine, July 16, 2015.

each classification is shown in the following chart:[6]

EMPLOYEE	**INDEPENDENT CONTRACTOR**
Usually works for only one employer.	Generally provides services to more than one employer.
Works the hours set by the employer.	Sets his or her own hours.
Usually works at the employer's place of business.	Works out of his or her own office or home.
Often receives employment benefits, such as health and disability insurance.	Does not receive employment benefits from the employer.
Works under the control and direction of the employer.	Works relatively independently.
Accomplishes tasks in the manner the employer has requested.	Has the authority to decide how to go about accomplishing tasks, and does so without the employer's input.
Receives net salary after the employer has withheld income tax, Social Security and Medicare tax under the Federal Insurance Contributions Act (FICA).	Is not subject to tax or FICA withholding, but pays his or her own self-employment tax.
Will likely be eligible to receive unemployment compensation after lay off or termination.	Is not eligible for unemployment compensation benefits.
Will receive worker's compensation benefits for any workplace injury.	Is not eligible for worker's compensation benefits.
Is covered by federal and state wage and hour laws such as minimum wage and overtime rules.	Is paid according to the terms of the contract, and does not receive additional compensation for overtime hours worked.
Has the protection of workplace safety and employment anti-discrimination laws.	Usually is not protected by employment anti-discrimination and workplace safety laws.

Attached as **Exhibit B** are publicly available IRS memo sheets on the differences between an independent contractor and an employee. The test of whether someone is an independent contractor boils down to the amount of control the taxpayer (i.e., the Trustee) has over that individual. A worker who is subject to the control and directions of another only as the result of the work and not as to the method is an independent contractor.[7] A personal care attendant usually serves under the direction of the employer

[6]Adapted from http://employment.findlaw.com/hiring-process/being-an-independent-contractor.
[7]Treas. Reg. §31.3401(c)-1(b).

and is therefore an employee.[8]

B. **Consequences of Treating Caregiver as an Independent Contractor When Caregiver is really an Employee**. -- Numerous cases have considered whether an individual was working as an independent contractor or as an employee. In the cases involving domestic caregivers or health care aides, nearly all were found to be employees rather than independent contractors. When it is discovered that an independent contractor is really an employee, the tax and unemployment agencies require the employer or the employer's estate to pay the income and unemployment taxes that were not withheld, along with penalties for such non-payment. The parent (or Trustee) who has hired a caregiver, without going through an agency, should treat the caregiver as an employee and perform all of the following duties described in the next section of this outline. Numerous cases have reviewed claims by "employers" who were treated as "independent contractors" and confirmed the individual to be entitled to benefits of an employee at the employer's expense. Tax and unemployment agencies may require the employer (or even his estate) to pay the income and unemployment taxes that were not withheld, along with penalties for non-payment.[9]

V. **WHAT DOES THE TRUSTEE HAVE TO DO WHEN HIRING AN EMPLOYEE?** -- When a caregiver is hired directly by a Trustee, rather than hiring through an agency, the Trustee will be responsible for paying taxes and other costs. However, every state handles employment issues differently, so it is important to check with an accountant or payroll service that routinely handles these issues to make sure everything has been covered. Here are six of the expected requirements.

A. **Obtain the Employer's Tax ID Number (EIN)**. -- This nine digit number, assigned by the IRS, will identify the Trust as a business entity hiring a worker. IRS Form SS-4 is used for this purpose. If the Trust is a self-settled, first-party trust and is using the beneficiary's Social Security Number, a separate EIN number will be needed. EIN numbers may be obtained on-line

[8] Frolick & Brown, Elderly & Disabled Clients, ¶16.12[2][c], pp. 16-50 (2013).
[9] **Estate of Dulaney v. Miss. Employment Security Commission**, 805 So.2d 643 (Miss. 2002).

at www.irs/Businesses/Small-businesses-&-Self-Employed/How-to-apply-for-an-EIN.

B. **Verify Employee Work Eligibility**. -- The U.S. Citizenship and Immigration Services (www.uscis.gov) requires all employers to verify an individual's eligibility to work in the United States by completing IRS form I-9. This form does not have to be submitted to the federal government, but it is important if hiring a non-family member to determine the employee's identity and employment authorization.

C. **Satisfy Federal and State Tax Reporting Requirements**. -- Determining whether the caregiver is an employee or an independent contractor is the first step in this area. The independent contractor is responsible for reporting and paying his or her own social security and income taxes; however, if the independent contract is paid $600 or more in one calendar year, then the employer is required to give the caregiver a Form 1099 MISC, which is a miscellaneous income reporting of what has been paid to the caregiver. The employer is required to file a copy of the Form 1099 MISC with the Internal Revenue Service.

With respect to employees (either part-time or full-time), the employer must obtain and complete IRS Form W-4 (Employee's Withholding Allowance Certificate), to indicate the number of allowances the employee is claiming for tax purposes. Is the employee electing to cover his spouse and dependents as well as himself? The Trustee, as employer, is responsible for withholding certain taxes based on the allowances claimed. These withholdings include Federal income, Social Security and Medicare taxes, as well as Federal Unemployment Taxes. State and local income taxes may also be required to be withheld, depending on the specific state's laws. In addition, an employer is also responsible for reporting the amount of wages paid and taxes withheld for each employee using a Form W-2. Professional payroll services or accountants or even QuickBooks (QB Payroll) are essential to set up this reporting.

An employee with no income tax liability is exempt from income tax withholding, and should indicate on Form W-4 that he expects to have no federal income tax liability for the current year, and that he had no federal income tax liability for the previous year![10]

D. **Report New Hires to the State Directory**. -- To determine whether the employer must register and pay state unemployment tax for a caregiver, the employer should contact the appropriate state taxing authority, which is often referred to as the state directory. This should occur within twenty (20) days after the date of hire, although some states accept the information if the first regularly scheduled payroll date is more than twenty (20) days after the date of hire. The Small Business Administration maintains a website for a list of new hire reporting centers in each state.

E. **Obtain Worker's Compensation Insurance**. -- Most states require a caregiver who is an employee and not an independent contractor to be covered under worker's compensation. In some states, the failure to provide worker's compensation coverage is a criminal offense. Worker's compensation laws differ among the states slightly in details, such as benefit rates and procedural rules governing employers, employees and insurance firms. Again, consult with an experienced accountant, payroll service or worker's compensation provider in order to correctly implement and pay worker's compensation. Many caregivers of persons with a disability have sustained work-related injuries. In general, homeowner's insurance policies do not cover a caregiver for an employment related personal injury. This coverage is critical so that the Trust, the employer, the homeowner, and the person with a disability do not face personal liability to the caregiver for an injury.

F. **Consider Additional Insurance**. -- In addition to worker's compensation insurance, consider other forms of insurance protection when the caregiver is not a parent. Obtaining umbrella coverage under a homeowner's policy is relatively

[10] IRC §3402(n).

inexpensive and can be important if the caregiver has an accident while working (e.g., tripping down steps). Insurance for casualty losses from a caregiver's theft may also be important. The Trustee should work with an insurance agent to make sure that there is adequate and appropriate coverage in place for these concerns.

VI. **HIRING A CAREGIVER THROUGH AN AGENCY OR HIRING DIRECTLY.** -- If the parent is a caregiver, the Trustee will likely hire the parent directly, rather than going through an agency. Where a parent or other family member is not the one being hired, however, it may be worth using a homecare agency. The agency may not be the least expensive option, but the value the agency can provide may be well worth the extra cost. All of the issues regarding withholding, payment of payroll taxes and worker's compensation, and additional insurance may be solved when an agency provides the caregiver. In addition, agencies often instruct caregivers how to work specifically with people with special needs, and the Trustee may request caregivers with specific training. Also, agencies will typically have a back-up person to send if the primary caregiver is ill or quits unexpectedly. On occasion, caregivers will ask to be paid under the table. A Trustee should never agree to this arrangement. Using an agency is one way to make sure this doesn't happen.

VII. **TAX CREDITS FOR THE COST OF CAREGIVERS.** -- While the cost of caregivers may be one of the largest expenditures a trust or a family faces, some tax credits thankfully exist for income tax purposes as a result of these expenditures. For dependent children under age 17 at year end,[11] the parent may claim a nonrefundable tax credit of $1,000 for each qualifying child.[12] To the extent adjusted gross income exceeds $110,000 for married couples filing jointly (or $75,000 for unmarried individuals or $55,000 for married filing separately) the amount of the credits is reduced by $50 for each $1,000 of excess.

A taxpayer with a qualifying child (different definition than for purposes of child care credit) in the household may also claim a credit for a percentage of employment related

[11] This is referred to as a "qualifying child." IRC §24(c).
[12] IRC §24.

dependent care expenses. In this scenario, the "qualifying individual" may either be:

1. A dependent of the taxpayer under the age of 13 for whom the taxpayer can claim a dependency exemption; or

2. A dependent of the taxpayer who is physically or mentally incapable of self-care, which individual need not qualify as a dependency deduction for the taxpayer; or

3. The taxpayer's spouse if he or she is physically or mentally incapable of self-care.[13]

The amount of the credit in this circumstance is equal to the applicable percentage of employment-related expenses up to $3,000 for one child and up to $6,000 for two or more children. While the applicable percentage begins at 35 percent (35%), it quickly declines to 20 percent (20%) as adjusted gross income exceeds $15,000.[14] Note that payment for caregivers must be incurred in order for the taxpayer to be employed. These costs may include a child care center's fees as well as a caregiver in the home.[15] When taxpayers are married, the credit is limited to the lesser of each of their earned incomes, with an amount of $400 per month of income being deemed to any spouse who is incapable of self-care or is a student.[16]

VIII. **REPEAL OF EXEMPTIONS FOR HOME CARE COMPANIONS: THE NEW STATUS OF HOME CARE WORKERS UNDER THE FAIR LABOR STANDARDS ACT.** -- On August 21, 2015, the U.S. Court of Appeals for the District of Columbia Circuit, in the case of **Homecare Association of America v. Weil**,[17] reinstated regulations that will affect many home care workers, including some providing personal care services. These regulations will allow an estimated 2 million home care workers to qualify for minimum wage and overtime protection. This new rule is expected to be effective by January 2016. In the past, the Fair Labor Standards Act,

[13] IRC §21(b).
[14] IRC §21(a).
[15] IRC §21(b)(2).
[16] IRC §21(d).

which covered employees engaged in domestic services such as home health aides and personal care aides, specifically exempted "companions" from the protection from minimum wage and overtime. The Act defined "companion" as

> *Any employee employed on a casual basis in domestic service employment to provide babysitting services or any employee employed in domestic service employment to provide companionship services for individuals who (because of age or infirmity) are unable to care for themselves (as such terms are defined and delimited by regulations of the Secretary.)*[18]

Since 1974, the home care industry has changed dramatically from an increase in the elderly population and the increase in need for health aides and personal care services for persons with chronic conditions.[19] A caregiver employed today for a person with a disability typically does far more than provide companionship services. They assist with all of the activities of daily living, as well as providing paramedical care. However, up until now, these workers have not had a right to be paid minimum wage or overtime.

The new regulations made three (3) important substantive changes, as follows:

1. It revised the definition of "companionship services" to include much more narrow characteristics relating primarily to fellowship and engagement in social activities, such as conversation, reading, games, crafts, and accompanying a person on a walk, an errand or to an appointment or social event.[20] The rule explained that companionship could include provision of care, but only if it did not exceed twenty percent (20%) of the total hours worked. The definition of "provision of care" for the new regulations includes assistance with activities of daily living, as well as some light medical tasks such as administering medication.

2. The rule limited who could claim the exemption for companionship

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[17] **Homecare Association of America v. Weil**, No. 15-5018, 2015 WL 4978980 (D.C. Cir. Aug. 21, 2015).
[18] 29 U.S.C. §213(a)(15).
[19] **Sabitino and Newman**, "The New Status of Home Care Workers under the Fair Labor Standards Act," *Bifocal* July-August 2015, page 131.
[20] 29 C.F.R. §552.6.

services to the individual, family or household using the service. As a result, home care agencies employing "companions" could no longer claim an exemption even if the caregiver services were within the new narrow definition of companion.[21]

3. Only the individual, family or household using the "live-in domestic service" could claim the exemption. In other words, hiring a live-in worker to help a family member with activities of daily living will not require the payment of overtime, but will require minimum wage to be paid. An agency employing a worker to do these services will have to pay both.[22]

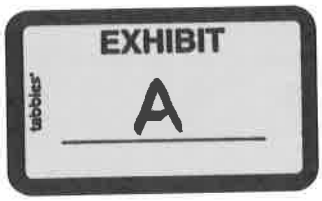
In a separate ruling in early 2015, the District Court overturned the Department of Labor's redefinition of the "companionship" exemption. However, on August 21, 2015, the U.S. Court of Appeals for the District of Columbia reversed the lower court's rulings and upheld the new rules.[23] Whether the case will be appealed to the U.S. Supreme Court is unknown.

Charles Sabatino and Caroleigh Newman in their *Bifocal* magazine article, stated that the impact of the new rule is clearly positive for direct care workers such as those providing personal care and home health aide services.[24] Sabatino and Newman noted that negative consequences have been predicted by others. For example, the National Federation of Independent Business issued a statement saying that the Department of Labor has effectively mandated home care providers to work in shorter shifts with reduced hours resulting in those who rely on these services receiving less personal care coupled with significantly rising prices.[25] The Department of Labor, however, noted that the high turnover rate in the industry may have been the result of low wages and long irregular hours, and that application of the new minimum wage and overtime compensation

[21] **Id.**
[22] **Id.**
[23] **Home Care Association of America v. Weil**, No. 15-5018, 2015 WL 4978980 (D.C. Cir. August 21, 2015).
[24] **Sabitino and Newman**, "The New Status of Home Care Workers under the Fair Labor Standards Act," *Bifocal* magazine. Vol. 36, No. 6, July/August 2015.
[25] http://www.nfib.com/article/?cmsid=63806.

protections may help reduce turnover rates.[26] Others predict that if the minimum wage is raised, financial issues may become worse as persons with disabilities can no longer afford the cost of care in their homes and must resort to skilled care or assisted living residences. Attached as **Exhibit C** is a letter recently sent to the Governors of the 50 states from the U.S. Secretary of Labor, Thomas E. Perez. This letter describes the effect of the decision by the U.S. Court of Appeals for the D.C. Circuit in **Homecare Association of America v. Weil**, and encourages each state to begin implementation of compliance with the new minimum wage and overtime compensation requirements.

[26]78 Fed. Reg. 60543 (Oct. 1, 2013).



PERSONAL SERVICES CONTRACT FOR CARE COORDINATION AND ASSISTANCE

This Contract is entered into by and between **Susan G. Sample** ("CARE RECIPIENT," hereinafter), and _____, relationship _____ ("CARE PROVIDER," hereinafter) on the date signed and dated below. It sets forth the terms under which CARE PROVIDER will provide personal assistance services to CARE RECIPIENT.

1. LOCATION OF CARE, INITIALLY. CARE PROVIDER will provide services as outlined herein for CARE RECIPIENT on an as-needed basis. CARE RECIPIENT is currently a resident of her home at 333 Amazing Avenue, Jefferson City, MO 65109 and services shall be provided there or where CARE RECIPIENT may be temporarily located.

2. **CARE RECIPIENT** agrees to receive, and CARE PROVIDER agrees to provide, the following services:

2.1. Monitor CARE RECIPIENT's physical and mental condition and nutritional needs on a regular basis, and coordinate modifications as needed to enable CARE RECIPIENT to age in place;

2.2. Arrange for transportation to health facility or physician of CARE RECIPIENT's choice. CARE PROVIDER shall also be available to assist in arranging for assessment, services and treatment by appropriate health care provider, including but not limited to, physicians, nurses, nursing home services, physical therapist, geriatric care manager, and mental health specialist as needed by CARE RECIPIENT;

2.3 Assist in monitoring the carrying out of instructions and directives from CARE RECIPIENT's health care provider;

2.4 In coordination with other agencies, arrange for social services by social service personnel as needed by CARE RECIPIENT;

2.5 Arrange for and take CARE RECIPIENT on outings in keeping with CARE RECIPIENT's lifestyle, as determined to be reasonable and feasible for CARE RECIPIENT; and

2.6 Interact with and/or assist any agent of CARE RECIPIENT in interacting with health professionals, hospital long-term care facility administrators, social service personnel, insurance companies, and government workers in order to safeguard CARE RECIPIENT's rights; benefits, or other resources as needed.

2.7 Participate in care plan meetings regarding the treatment, care and welfare of CARE RECIPIENT.

2.8 Assist CARE RECIPIENT with laundry as needed;

2.9 Purchase, with funds made available by CARE RECIPIENT, or assist CARE RECIPIENT in purchasing, clothing, toiletries, and other personal items for CARE RECIPIENT as needed, taking into account CARE RECIPIENT's ability to pay for such items;

2.10 Purchase, with funds made available by CARE RECIPIENT, or assist CARE RECIPIENT in purchasing hobby, entertainment or other goods for CARE RECIPIENT's use and enjoyment, as needed, taking into account CARE RECIPIENT's ability to pay for such items;

2.11 Assure the uninterrupted continuation of subscriptions (such as newspaper, magazine, cable television) and services (such as hair care and telephone service) requested by CARE RECIPIENT, taking into account CARE RECIPIENT's ability to use and pay for such items.

2.12 Maintain and care for the living area resided in CARE RECIPIENT, including general cleaning, routine maintenance, insurance, taxes, lawn care, and necessary repairs;

2.13 Maintain, protect, preserve, insure, remove, store, transport, repair, rebuild, modify, or improve all items of personal property owned by CARE RECIPIENT, wherever located, as directed by CARE RECIPIENT, taking into account CARE RECIPIENT's ability to pay for such maintenance;

2.14 Coordinate or assist managing CARE RECIPIENT's financial affairs, including paying CARE RECIPIENT's personal bills, monitoring CARE RECIPIENT's financial accounts, paying for rent, and personal property expenses; and any other financial transactions as directed by CARE RECIPIENT or her Attorney in Fact, taking into account CARE RECIPIENT's ability to pay for such items;

2.15 Coordinate or assist with activities of daily living for CARE RECIPIENT, such as ambulating, bathing, dressing, eating, toileting, continence care, transferring, and necessary management of medication or prompting of CARE RECIPIENT to take such medication.

2.16 Coordinate or assist in providing instrumentalities of daily living for CARE RECIPIENT, such as assuring that walkers or wheelchairs are available for ambulation; arranging the linens and personal toiletries for bathing; washing the clothes and choosing appropriate clothes to wear each day;

shopping for, preparing, and serving appropriate food and drink; prompting the CARE RECIPIENT to toilet when necessary and take measures for constipation or urinary tract issues; prompting change of clothes and cleanup and/or the wearing of diapers for incontinence; and assuring the proper furniture and equipment are available for transferring from bed to chair and from chair to a standing position.

3. DURATION. The services indicated above shall be provided to CARE RECIPIENT by CARE PROVIDER for so long as CARE RECIPIENT requires assistance with management of her personal needs and affairs and will discontinue once CARE RECIPIENT enters an intermediate care facility or skilled nursing facility. The services may also be discontinued upon notice by CARE PROVIDER that such services shall no longer be provided by CARE PROVIDER. Finally CARE RECIPIENT can decide to no longer receive care from this CARE PROVIDER.

4. COMPENSATION. CARE RECIPIENT agrees to pay, and CARE PROVIDER agrees to accept, as payment for the aforesaid services to be rendered by CARE PROVIDER, the compensation set forth below, which compensation the parties stipulate and agree to be fair and reasonable, commensurate with the quality and extent of these types of services and their fair market value.

4.1 The parties stipulate that persons who render and coordinate the aforesaid personal care services in this county through an agency generally receive the rate of $12.00 per hour including required withholdings. CARE RECIPIENT agrees to pay CARE PROVIDER $12.00 for each hour worked.

4.2 CARE RECIPIENT shall pay CARE PROVIDER for such services rendered pursuant to this Contract by the 15th day of the month following the month in which the services were rendered.

4.3. CARE RECIPIENT shall be responsible for employer duties and costs (such as employer taxes) and issuing a W-2 statement (if required by law) associated with the CARE PROVIDER providing services pursuant to this Contract. CARE RECIPIENT does not provide workers compensation or unemployment compensation coverage.

5. NON-ASSIGNABILITY. This Contract is for services unique to CARE RECIPIENT. CARE PROVIDER agrees to personally perform the above services. CARE PROVIDER shall have no obligation to render services or otherwise be liable to any other person or entity by virtue of this Contract.

6. LIABILITY. Medical care and treatment is to be provided at the expense of CARE RECIPIENT. CARE PROVIDER shall not be liable for the cost of CARE RECIPIENT's medical care.

7. EFFECTIVE DATE. This Contract shall take effect and be binding on the parties hereto upon commencement of services by CARE PROVIDER.

8. REPRESENTATIONS. The CARE PROVIDER represents to the CARE RECIPIENT as follows:

8.1 The CARE PROVIDER has never been, and is not now, the subject of any claim or court action (civil or criminal) alleging criminal or dishonest activity or the abuse or neglect of any person.

8.2 The CARE PROVIDER has no known medical condition (such as being subject to seizures or blackouts) which could result in risk to CARE RECIPIENT.

9. MISCELLANEOUS. The following miscellaneous provisions apply:

9.1 This Contract contains the entire Agreement and understanding between the parties, surpassing all prior communications, either written or oral, concerning the subject matter of this Contract. This Contract may be changed only by a written instrument executed by both parties hereto.

9.2 This Contract shall be governed by and construed in accordance with the laws of the State of Missouri.

9.3 This Contract is intended to satisfy the requirements of section 208.213.1 RSMo, and the services to be rendered are essential to avoid institutionalization of CARE RECIPIENT to receive long-term care and treatment.

9.4. CARE PROVIDER shall not be paid for care or treatment services to CARE RECIPIENT that duplicates those which another party is being paid to provide.

THIS IS A LEGALLY BINDING AGREEMENT. EACH PARTY HAS READ THE ABOVE CONTRACT BEFORE SIGNING IT. EACH PARTY UNDERSTANDS THE CONTRACT HE OR SHE IS MAKING. EACH PARTY HAS HAD THE OPPORTUNITY TO ASK TO HAVE EACH TERM FULLY EXPLAINED BEFORE SIGNING.

We, the CARE PROVIDER and the CARE RECIPIENT, having read this Personal Services Contract for Care Coordination and Assistance, agree to its terms and sign it as our free acts and deeds on the date(s) set forth below.

CARE PROVIDER:

_____ Date: _____

Signature

_____

Print Name

CARE RECIPIENT:

_____ Date: _____

Susan G. Sample

Prepared by Reginald H. Turnbull, Esq., Turnbull & Stark, P. C., 573-634-2910, July 14, 2015

EXHIBIT A

A Nonexclusive Listing of the Extraordinary Services to be Provided by Caregiver

1. Applying and removing the Ankle-Foot Orthosis on a nightly basis.
2. Changing the percutaneous endoscopic gastrostomy (PEG) in the stomach.
3. Administering medications at least three times each day.
4. Giving of an enema on a bi-weekly basis.
5. Apply specific treatments and therapies as instructed by speech, physical and occupational therapists on a daily basis.

EXHIBIT B

IRS

Small Business/Self-Employed

- Industries/Professions
- International Taxpayers
- Self-Employed
- Small Business/Self-Employed Home

Small Business/Self-Employed Topics

- A-Z Index for Business
- Forms & Pubs
- Starting a Business
- Deducting Expenses
- Businesses with Employees
- Filing/Paying Taxes
- Post-Filing Issues
- Closing Your Business

Independent Contractor (Self-Employed) or Employee?

Español | 中文 | 한국어 | TiếngViệt | Русский

It is critical that business owners correctly determine whether the individuals providing services are employees or independent contractors.

Generally, you must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. You do not generally have to withhold or pay any taxes on payments to independent contractors.

Select the Scenario that Applies to You:

- **I am an independent contractor or in business for myself**
  If you are a business owner or contractor who provides services to other businesses, then you are generally considered self-employed. For more information on your tax obligations if you are self-employed (an independent contractor), see our Self-Employed Tax Center.
- **I hire or contract with individuals to provide services to my business**
  If you are a business owner hiring or contracting with other individuals to provide services, you must determine whether the individuals providing services are employees or independent contractors. Follow the rest of this page to find out more about this topic and what your responsibilities are.

Determining Whether the Individuals Providing Services are Employees or Independent Contractors

Before you can determine how to treat payments you make for services, you must first know the business relationship that exists between you and the person performing the services. The person performing the services may be -

- An independent contractor
- An employee (common-law employee)
- A statutory employee
- A statutory nonemployee

In determining whether the person providing service is an employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered.

Common Law Rules

Facts that provide evidence of the degree of control and independence fall into three categories:

1. Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?
2. Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
3. Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Businesses must weigh all these factors when determining whether a worker is an employee or independent contractor. Some factors may indicate that the worker is an employee, while other factors indicate that the worker is an independent contractor. There is no "magic" or set number of factors that "makes" the worker an employee or an independent contractor, and no one factor stands alone in making this determination. Also, factors which are relevant in one situation may not be relevant in another.

The keys are to look at the entire relationship, consider the degree or extent of the right to direct and control, and finally, to document each of the factors used in coming up with the determination.

Form SS-8

If, after reviewing the three categories of evidence, it is still unclear whether a worker is an employee or an independent contractor, Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (PDF) can be filed with the IRS. The form may be filed by either the business or the worker. The IRS will review the facts and circumstances and officially determine the worker's status.

Be aware that it can take at least six months to get a determination, but a business that continually hires the same types of workers to perform particular services may want to consider filing the Form SS-8 (PDF).

Employment Tax Obligations

Once a determination is made (whether by the business or by the IRS), the next step is filing the appropriate forms and paying the associated taxes.

- Forms and associated taxes for independent contractors
- Forms and associated taxes for employees

Employment Tax uidelines

There are specific employment tax guidelines that must be followed for certain industries.

- Employment Tax Guidelines: Classifying Certain Van Operators in the Moving Industry (PDF)
- Employment Tax Procedures: Classification of Workers within the imousine Industry (PDF)

Misclassification of Employees

Conse uences of Treating an Employee as an Independent Contractor

If you classify an employee as an independent contractor and you have no reasonable basis for doing so, you may be held liable for employment taxes for that worker (the relief provisions, discussed below, will not apply). See Internal Revenue Code section 3 for more information.

Relief Provisions

If you have a reasonable basis for not treating a worker as an employee, you may be relieved from having to pay employment taxes for that worker. To get this relief, you must file all re uired federal information returns on a basis consistent with your treatment of the worker. You (or your predecessor) must not have treated any worker holding a substantially similar position as an employee for any periods beginning after 1 . See Publication 1 , Section 3 Employment Tax Relief Re uirements (PDF) for more information.

Misclassified Wor ers Can File Social Security Tax Form

Workers who believe they have been improperly classified as independent contractors by an employer can use Form 8 1 , ncollected Social Security and Medicare Tax on Wages to figure and report the employee's share of uncollected Social Security and Medicare taxes due on their compensation. See the full article Misclassified Workers to File ew Social Security Tax Form for more information.

oluntary Classification Settlement Program

The Voluntary Classification Settlement Program (VCSP) is a new optional program that provides taxpayers with an opportunity to reclassify their workers as employees for future tax periods for employment tax purposes with partial relief from federal employment taxes for eligible taxpayers that agree to prospectively treat their workers (or a class or group of workers) as employees. To participate in this new voluntary program, the taxpayer must meet certain eligibility re uirements, apply to participate in the VCSP by filing Form 8 2, Application for Voluntary Classification Settlement Program, and enter into a closing agreement with the IRS.

Rate the Small Business and Self-Employed Website

Page Last Reviewed or Updated: 05-Aug-2015

IRS

Topic 762 - Independent Contractor vs. Employee

For federal employment tax purposes, the usual common law rules are applicable to determine if a worker is an independent contractor or an employee. Under the common law, you must examine the relationship between the worker and the business. You should consider all evidence of the degree of control and independence in this relationship. The facts that provide this evidence fall into three categories – Behavioral Control, Financial Control and the Relationship of the Parties.

Behavioral Control covers facts that show if the business has a right to direct and control what work is accomplished and how the work is done, through instructions, training or other means.

Financial Control covers facts that show if the business has a right to direct or control the financial and business aspects of the worker's job. This includes:

- The extent to which the worker has unreimbursed business expenses
- The extent of the worker's investment in the facilities or tools used in performing services
- The extent to which the worker makes his or her services available to the relevant market
- How the business pays the worker, and
- The extent to which the worker can realize a profit or incur a loss

Relationship of the Parties covers facts that show the type of relationship the parties had. This includes:

- Written contracts describing the relationship the parties intended to create
- Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay
- The permanency of the relationship, and
- The extent to which services performed by the worker are a key aspect of the regular business of the company

For more information, refer to Publication 15-A (PDF), *Employer's Supplemental Tax Guide*, or Publication 1779 (PDF), *Independent Contractor or Employee*. If you want the IRS to determine if a specific individual is an independent contractor or an employee, file Form SS-8 (PDF), *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. For information on eligibility for a voluntary program to reclassify your workers as employees with partial relief from federal employment taxes, visit Voluntary Classification Settlement Program (VCSP) on IRS.gov.

More Tax Topic Categories

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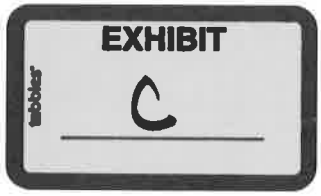
SECRETARY OF LABOR
WASHINGTON, D.C. 20210



SEP - 2 2015

Dear Governor:

On August 21, 2015, the U.S. Court of Appeals for the District of Columbia Circuit issued a unanimous decision upholding the validity of the U.S. Department of Labor's Home Care Final Rule that requires the payment of minimum wage and overtime compensation to most home care workers. This decision is vital to nearly two million home care workers, who will now qualify for minimum wage and overtime protections. Although the court's opinion does not take effect immediately and the timeline for issuance of the court's mandate depends on various factors, I am writing to again encourage your State to thoughtfully prepare for compliance now.

As you know, this is a crucial issue affecting many of your State's citizens, including low-wage workers, seniors, and individuals with disabilities, that could require an adjustment to your State's budget or programs as well as careful and timely attention to the legal rights afforded to individuals with disabilities. Throughout this process, we have stressed two key implementing principles – protecting the rights of workers *and* supporting the individuals who rely on home care services by not interfering with the innovative models of care that allow them to stay in their homes and communities. These twin principles guide our implementation – as they should guide yours – because fair wages for home care workers and independent living are not mutually exclusive. In fact, they build on one another, because a qualified, stable workforce is critical to ensuring that seniors and individuals with disabilities can remain in their homes. Although there may be additional costs that accompany the provision of minimum wage and overtime protections to home care workers, by professionalizing this critical workforce we will reduce the costs associated with high turnover in the home care industry, avoid the high cost of unnecessary institutional care and ensure that our citizens will be able to remain fully engaged in their own homes and communities.

Thoughtful implementation of the rule also includes compliance with states' obligations under the Americans with Disabilities Act and the Supreme Court's *Olmstead* decision. We explained in the Final Rule itself that in order to comply with these obligations, "public entities must have in place an individualized process – available to any person whose service hours would be reduced as a result of the Final Rule – to examine if the service reduction would place the person at serious risk of institutionalization and, if so, what additional or alternative services would allow the individual to remain in the community."

As part of our collaborative efforts with our federal partners, the U.S. Department of Justice and the U.S. Department of Health and Human Services jointly issued a "Dear Colleague" letter, available at http://www.ada.gov/olmstead/documents/doj_hhs_letter.pdf, that addresses those obligations. As you consider possible changes to your State's home care programs in order to come into compliance with the minimum wage and overtime compensation requirements

mandated by the Home Care Final Rule, it is imperative that you consider the information in this letter. The letter emphasizes that "states need to consider reasonable modifications to policies capping overtime and travel time for home care workers, including exceptions to these caps when individuals with disabilities otherwise would be placed at serious risk of institutionalization." Inflexible state caps on the number of hours personal assistants may work could violate the ADA and *Olmstead* if they place individuals with disabilities at serious risk of institutionalization or segregation.

Since publication of the Home Care Final Rule on October 1, 2013, nearly two years ago, the Department has led an unprecedented implementation program to help states prepare for compliance, including offering an extensive and individualized technical assistance program, providing a 15-month period before the effective date to aid compliance, and adopting a time-limited non-enforcement policy (described in detail on our website at http://www.dol.gov/whd/homecare/non-enforcement_policy.htm). I am confident that you and your staff can implement this Rule in a manner that affords due respect for workers, seniors, and individuals with disabilities. I continue to stand ready to assist you as you do so.

Sincerely,

THOMAS E. PEREZ

U.S. Department of Justice
Civil Rights Division

Department of Health and Human Services
Office for Civil Rights

December 15, 2014

Dear Colleague:

On October 1, 2013, the Department of Labor promulgated a rule extending the minimum wage and overtime protections of the Fair Labor Standards Act (FLSA) to most home care workers ("Home Care Rule"). Application of the Fair Labor Standards Act to Domestic Service, 78 Fed. Reg. 60,454 (Oct. 1, 2013). The Home Care Rule becomes effective on January 1, 2015.[1]

The Civil Rights Division and the Department of Health and Human Services' Office for Civil Rights (OCR) recognize the importance of ensuring adequate workplace protections for home care workers, who provide critical services to millions of Americans. At the same time, it is important that states implement the Department of Labor's rule in ways that also comply with their obligations under Title II of the Americans with Disabilities Act (ADA). In particular, because home care workers, such as personal care assistants and home health aides, often provide essential services that enable people with disabilities to live in their own homes and communities instead of in institutions, states should consider whether reasonable modifications are necessary to avoid placing individuals who receive home care services at serious risk of institutionalization or segregation.

The Department of Justice and OCR enforce the rights of people with disabilities to live integrated lives free from unnecessary segregation in institutions. Specifically, Title II of the ADA requires that "no qualified individual with a disability shall, by reason of such disability, be excluded from participation in or be denied the benefits of the services, programs, or activities of a public entity, or be subjected to discrimination by any such entity."[2] As directed by Congress, the Attorney General issued regulations implementing Title II, which are based on regulations issued under section 504 of the Rehabilitation Act.[3] The Title II regulations require public entities to "administer services, programs, and activities in the most integrated setting

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[1] The Department of Labor announced that it will not bring an enforcement action against any employer related to FLSA obligations under the new Home Care Rule before June 30, 2015. It will then use prosecutorial discretion until December 31, 2015 to determine whether to bring enforcement actions, taking into account the good faith efforts of states and other entities to bring their home care programs into compliance with the Home Care Rule. Application of the Fair Labor Standards Act to Domestic Service; Announcement of Time-Limited Non-Enforcement Policy, 79 Fed. Reg. 60,974 (Oct. 9, 2014).

[2] 42 U.S.C. § 12132 (1990).

[3] *See id.* § 12134(a); 28 C.F.R. § 35.190(a) (1991); Exec. Order No. 12,250 (1980), 45 Fed. Reg. 72,995 (1980), *reprinted in* 42 U.S.C. § 2000d-1. Section 504 of the Rehabilitation Act of 1973 similarly prohibits disability-based discrimination. 29 U.S.C. § 794(a) ("No otherwise qualified individual with a disability . . . shall, solely by reason of her or his disability, be excluded from the participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance . . . .").

appropriate to the needs of qualified individuals with disabilities."[4] The preamble discussion of the "integration regulation" explains that "the most integrated setting" is one that "enables individuals with disabilities to interact with nondisabled persons to the fullest extent possible . . . ." [5]

In *Olmstead v. L.C.*, 527 U.S. 581 (1999), the Supreme Court held that Title II's integration mandate prohibits the unjustified segregation of individuals with disabilities. Furthermore, compliance with Title II's integration mandate requires that public entities reasonably modify their policies, procedures, or practices when necessary to avoid discrimination.[6] The obligation to make reasonable modifications may be excused only where the public entity demonstrates that the requested modifications would "fundamentally alter" its service system.[7]

Moreover, the ADA and the *Olmstead* decision are not limited to individuals currently in institutional or other segregated settings. They also apply to persons at serious risk of institutionalization or segregation. For example, a public entity could violate *Olmstead* if it fails to provide community services, or reduces those services, in a way likely to cause a decline in health, safety, or welfare leading to an individual's eventual placement in an institution.

The Department of Labor's Home Care Rule narrows the circumstances in which the companionship services and live-in domestic service employee exemptions from FLSA protections apply, both by updating the definition of "companionship services" and by prohibiting third party employers from claiming either exemption. Because of these changes, most home care workers, including those providing services through publicly funded programs, will be entitled to receive at least the Federal minimum wage for all hours worked and overtime compensation—one and a half times the worker's regular hourly rate of pay—for all hours worked over 40 in a workweek.

Implementation of the Home Care Rule will require each public or private agency that administers or participates in a consumer-directed home care program, including those funded by Medicaid, to evaluate whether it is a joint employer under the FLSA. If it is a joint employer, the entity will then be responsible for compliance with the requirements of the FLSA. The Act's minimum wage requirement applies to any time spent traveling between worksites—in the home care context, the consumer's home—when employed by the same sole or joint employer at each worksite. The FLSA's overtime compensation requirement includes, in the home care context, combined hours spent working for more than one consumer as part of the joint employment by the third party entity. More information and guidance regarding the Home Care Rule can be found at: U.S. Dept. of Labor, Wage and Hour Div., *We Count on Home Care*, available at: http://www.dol.gov/whd/homecare/ (last visited December 5, 2014).

The Civil Rights Division and OCR encourage states to conduct a thorough analysis of all their home care programs to determine whether any changes must be made to comply with the FLSA once the Home Care Rule becomes effective. In planning implementation steps, states must

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[4] 28 C.F.R. § 35.130(d) (1991).
[5] 28 C.F.R. Pt. 35, App. B at 673 (2011).
[6] 28 C.F.R. § 35.130(b)(7) (1991).
[7] *Id.*; *see also Olmstead*, 527 U.S. at 604-07.

consider whether reasonable modifications are necessary to avoid placing individuals who receive home care services at serious risk of institutionalization or segregation.[8] A state's obligation to make reasonable modifications to its policies, procedures, and practices applies even when a home care program is delivered through non-public entities.

Many states are already taking concrete steps to implement the Home Care Rule. Some states are developing budget proposals to pay overtime and travel time for home care workers who work over 40 hours in a week. The Centers for Medicare and Medicaid Services (CMS) has published guidance to assist states in understanding Medicaid reimbursement options that will enable them to account for the cost of overtime and travel time that may be compensable as a result of the Home Care Rule. *See* Cindy Mann, *CMCS Informational Bulletin: Self-Direction Program Options for Medicaid Payments in the Implementation of the Fair Labor Standards Act Regulation Changes* (July 3, 2014), http://www.medicaid.gov/Federal-Policy-Guidance/Downloads/CIB-07-03-2014.pdf.

Other states are planning to comply with the new rule by setting limits or capping direct care workers' hours or travel time. We are sensitive to states' budgetary constraints. However, implementation of across-the-board caps risks violating the ADA if the caps do not account for the needs of individuals with disabilities and consequently places them at serious risk of institutionalization or segregation. For example, if a state prohibits home care workers from exceeding 40 hours a week of work, individuals who need more than 40 hours a week of care may not receive their full hours where home care workers are scarce. And even where home care workers are available, consumers with extraordinary medical or behavioral needs may not be able to tolerate multiple workers in their home. Emergency situations may also arise where a scheduled second worker is not available and the individual's home care support needs would not be met without immediate authorization of overtime hours and pay.

Therefore, states need to consider reasonable modifications to policies capping overtime and travel time for home care workers, including exceptions to these caps when individuals with disabilities otherwise would be placed at serious risk of institutionalization.[9] Whether a reasonable modification is needed and what the modification should be depends on the specific factual circumstances. States should also consider implementing processes that reliably and expeditiously enable individuals with disabilities to obtain cap exceptions when they are warranted. Finally, where implementation of the Home Care Rule disrupts services, states should collect and monitor data to ensure that the service disruption does not place individuals with disabilities at serious risk of institutionalization.

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[8] In the final Home Care Rule regulations, the Department of Labor recognized states' obligations to comply with the requirements of the Americans with Disabilities Act when considering changes to implement the Home Care Rule. 78 Fed. Reg. 60,454, 60,485-87.

[9] CMS has similarly encouraged states to consider exceptions to limitations on overtime and travel time when necessary to avoid placing an individual at risk of harm. *See* Cindy Mann, *CMCS Informational Bulletin: Self-Direction Program Options for Medicaid Payments in the Implementation of the Fair Labor Standards Act Regulation Changes* (July 3, 2014), http://www.medicaid.gov/Federal-Policy-Guidance/Downloads/CIB-07-03-2014.pdf.; *see also* CMS, *Application for a § 1915(c) Home and Community-Based Waiver, Instructions, Technical Guide and Review Criteria* at 141 (January 2008), http://www.medicaid.gov/Medicaid-CHIP-Program-Information/By-Topics/Waivers/Downloads/Technical-Guidance.pdf.

For more information regarding states' obligations under *Olmstead* and the Americans with Disabilities Act's integration mandate, visit *Statement of the Department of Justice on Enforcement of the Integration Mandate of Title II of the Americans with Disabilities Act and Olmstead v. L.C.*, available at: http://www.ada.gov/olmstead/q&a_olmstead.htm (last visited December 5, 2014).

The Civil Rights Division and OCR recognize and appreciate the work that states do in supporting individuals with disabilities to live integrated lives in their communities.

/s/ Vanita Gupta
Vanita Gupta
Acting Assistant Attorney General
Civil Rights Division
U.S. Department of Justice

/s/ Jocelyn Samuels
Jocelyn Samuels
Director
Office for Civil Rights
Department of Health and Human Services