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Can School Tuition and Educational Fees Be Income Tax Deductions?

Introduction

The past several years have seen growing numbers of schools and programs within schools intended to provide treatment and education to students with learning and other disabilities, including emotional and behavioral disorders. Reasons for this are varied, but certainly include increased awareness and understanding about learning disabilities, more effective identification and diagnosis of learning difficulties and disabilities combined with better treatment methods. Many of these programs are costly, and insurance coverage is often limited, at best. Parents with children who can benefit from these programs and even tax advisers are often not aware that some or all of the cost of such schools or programs may qualify as a tax-deductible medical expense.

Potential Tax Benefits of Medical Expenses

Taxpayers need to know that medical expenses can create potential tax benefits in a variety of ways.

- The expenses may be tax deductible as an itemized deduction. The amount deductible is only the amount by which unreimbursed payments for medical expenses exceeds 10% of adjusted gross income for the year (A 7.75% floor applies in some cases). Taxpayers whose expenses exceed this threshold are allowed a deduction to the extent of the excess. The expenses below the threshold are not deductible.

- The expenses may be reimbursed on a tax favored basis from a Cafeteria Plan even if total medical expenses do not exceed the 10% threshold. A Cafeteria Plan is a written plan that is funded by employee contributions on a pre-tax salary reduction to provide coverage for specified expenses, including medical expenses. Medical expense reimbursements are limited to \$2500 per year beginning in 2013.
- Additionally, taxpayers may also be permitted to take distributions from qualified retirement plans for medical hardship. These distributions should be viewed as a last resort since the distributions are subject to both income tax and frequently additional potential penalties for premature retirement distributions. In limited circumstances taxpayers whose medical expenses exceed the 10% floor may be able to avoid penalties on the amount the taxpayer is allowed to deduct as an itemized deduction.

Medical Expenses in General

An individual is entitled to an itemized deduction for expenses paid during the tax year for the medical care of the individual, the individual's spouse, or a dependent to the extent that such expenses exceed the 10% threshold. Medical expenses can be defined as amounts paid "for the diagnosis, cure, mitigation, treatment, or prevention of disease or for the purpose of affecting any structure or function of the body." Qualifying medical expenses include doctor and dentist fees, hospital and nursing services, laboratory services, prescriptions and drugs, and health insurance. Qualified expenses may also include the cost of a "special school".

What is a Special School?

It is accepted that school tuition and fees may meet the Internal Revenue Code definition of medical expenses. According to the IRS Regulations, “While ordinary education is not medical care, the cost of medical care includes the cost of attending a special school for a mentally or physically handicapped individual, if his condition is such that the resources of the institution for alleviating such mental or physical handicap are a principal reason for his presence there.” Also, “In such a case the cost of attending such a special school will include the cost of meals and lodging, if supplied, and the cost of ordinary education furnished which is incidental to the special services furnished by the school.” And further, that, “... the cost of medical care includes the cost of attending a special school designed to compensate or overcome a physical handicap, in order to qualify the individual for future normal education or for normal living...”

The singular distinguishing characteristic of a special school is the substantive content of its curriculum. The curriculum may include some ordinary education, but only if incidental to the primary purpose of the school, enabling the student to compensate for or overcome a handicap.

The Regulations cite schools that teach Braille or lip reading as examples of such special schools. Case law and IRS rulings have made it clear, however, that the application is broader than this. Other examples of qualifying circumstances include costs of schools with special programs designed to treat the following:

- Severe learning disabilities caused by neurological disorders
- Inability to function in a normal school setting due to emotional reactions to parents' divorce, or to detrimental relationship with a parent

- Severe adjustment reactions, including depression, to adolescence at a school admitting only students with average to above-average intelligence
- The incremental costs of a special program within a private school for students with a written diagnosis of attention deficit hyperactivity disorder
- Behavioral problems due to chronic drug abuse
- Dyslexia and other specific learning disabilities

How does a Student Qualify?

Establishing that the school or program is a special school is only the first step. In addition, the taxpayer must also show that the student has a medical need for the resources of the school and that the school's program is intended and expected to be of medical benefit. Key questions to be asked in this regard are as follows:

- What is the principle purpose for which the expenditure was made?
- Was it made on the advice of a physician?
- Did it have a direct relationship to the treatment of a specific disease, or physical or mental condition?
- Could the treatment reasonably be expected to be effective in the diagnosis or treatment, or to affect any structure or function of the body?

If these tests are met, the costs of the school can reasonably be expected to qualify as medical expenses under the Internal Revenue Code.

Other Potential Medical Expenses

Other expenses of qualified students attending special schools may also qualify as medical expenses. Examples include:

- Meals and lodging if paid to and provided by the school as part of its program
- Incidental fees and expenses if directly related to the school's program
- Local transportation
- The attendee's transportation cost if the school is in another city, or family members' out-of-town transportation cost if visiting the attendee is part of the school's program

Conclusion

One reason that potential deductibility of school tuition and fees is often overlooked is because it is expected that medical expenses will not exceed the 7.5% of AGI threshold. Typically, families with special needs children will also have substantial other non-reimbursed medical expenses. Alone, either these expenses or a special school's tuition and fees may not exceed the threshold, but when combined often will. Taxpayers increasingly need to understand these rules and their potential benefits.

Disclaimer

This article is intended to be a general explanation of the tax rules and is not intended to address specific cases. Determination of whether an expense qualifies as a medical expense for income tax purposes depends upon individual facts and circumstances.

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