Tax Letter

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Dear clients and friends:

Study after study, survey after survey, all confirmed that America is aging. This means that the number of older people in the United States as a radio to the total population is growing. In just a few years, the group of people commonly known as the "Boomers" will be in line for "senior-ship", reaching the magic age of 65. There are many things in life; a senior must be careful, much more so than someone younger, particularly in the area of medical care and retirement. When the thinking is in the area of medical care, most likely many seniors will concentrate in the choosing of care itself, such as the care provider, the doctor, the hospital, and the insurance arrangement. The questions of Medicare, Medic-gap coverage and/or some other form of private substitution, definitely, are very important. However, the equally important funding source and the related tax benefits and implication are routinely ignored. Likewise, when the decision making is for retirement planning, most seniors will concentrate in the planning of the investment and the investment returns. The questions regarding the corresponding tax implication will, usually, be overlooked.

Since the delivery and coverage of medical care as well as investing for retirement are not within the scope of this letter, we therefore chose to discuss certain tax benefits and implication specifically affecting seniors.

(A) **Medical and Medical care**: If it is a medical necessity, costs of special equipment installed in a home, or qualified portion of total costs for major improvement or modification to a home, can be deducted as medical expenses. According to the IRS Publication number 502, (1) if medically necessary, costs for many items can be deducted, for example, constructing entrance or exit ramps, widening doorways or exits, widening or modifying hallways and interior doors, installing railing, modification to bathrooms and kitchen counters, cabinets and equipments, etc.; and (2) if medically necessary, the total costs of major improvement to the house in excess of specific "value increase" associated with the improvement can be deducted as qualified medical expenses. Further, according to IRC sections 213 and 7702, premium paid for long term care insurance policy and actual amount paid for qualified long term care services, including but not limited to diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative, and personal care services, can be deducted as medical expenses as long as they are required by a chronically ill person and the services are provided in accordance with a prescribed plan of care by a licensed health care practitioner.

(B) **Retirement and Estate planning:** When it comes to retirement planning, most seniors will concentrate in certain investment programs and their returns. Yes, to have sufficient funding for a long and comfortable retirement life is very important. Once retirement funding has been taken care of, seniors should seriously plan for events after death. The so called "estate planning" usually will concentrate in the distribution and the taxation of the assets in the Estate. Routinely, the planners will overlook certain important "loss carryovers", such as the net operating loss and the capital loss carryovers, and the unused passive activity losses. Net operating losses and capital losses belong to and/or allocated to the decedent cannot be carried over and used in future years by anyone, including the surviving spouse. They can be used in the decedent's final tax return, filed with or without the surviving spouse. At the same token, unused passive activity losses, which would otherwise be suspended, can not be carried over and will expire at the date of death. Therefore, during the process of planning for investment and estate distribution, seniors and their planners should not forget these losses. They are, in fact, invisible assets. On the other hand, the tax implication concerning certain visible assets is easily forgotten. These assets are pre-tax retirement savings, such as IRA, 401K, and etc. Since the related income taxes have not been paid, and should be recognized as taxable income upon withdrawal, any person inherited these funds must pay the taxes on behalf of the decedent. If the person inheriting these funds is a surviving spouse, in general, will have better income tax alternatives than a non surviving spouse. Nonetheless, seniors should take this tax impact into their consideration when planning for events after death.

(C) **Regarding life insurance**: In many situations, the last resource for retirement living for many seniors would be their home. It is possible and not unusual for a senior to face financial shortage a few years after retirement. In this incidence, the senior will most likely thinking about the equity of his or her home, and very rarely will think of cashing out his or her life insurance policy. When a senior retiree's retirement fund is near exhausted, chances are, his or her age will be much older and has been in retirement for a number of years. Continue to maintain a life policy, in my opinion, is wasteful. Any valid life insurance policy with reasonable length of time remaining definitely has determinable value, not just the cash surrender value. If it is a "whole life" type policy which has a set cash surrender value, the senior has a choice. Either surrender the policy for the stated cash value, or transfer the policy to a viatical settlement provider for, perhaps, a much higher amount. Further, the taxable amount of any stated cash surrender value of a life policy will be taxed as ordinary income, while the taxable amount, if any, from a viatical settlement will be taxed as long term capital gain. If the policy is a "term life" type policy which has no cash surrender value, as long as the policy can be continued for an acceptable length of time, the senior would be in a position to negotiate a viatical settlement. In general, the cash received will not be taxable. If any amount received from the viatical settlement is taxable, it will be treated as long term capital gain

If you need any further information please give us a call at **415-381-0681**, or visit or web site at **www.chochan.com**.

Sincerely,

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