

Are Refundable Entry Fees at CCRCs Taxed When Received?

Continuing care retirement communities, also referred to as life plan communities, often require an entry fee in exchange for lifetime housing and priority access to healthcare. In many cases, a sizable portion of the entry fee may be refundable to the resident if they move out, or to the resident's heirs at death.

A question that some prospective residents may have is whether a refundable entry fee might be taxed when received. To help answer this question it is necessary to first describe refundable entry fees in a little more detail.

Entry fee retirement communities often make two options available:

1. Traditional, declining balance contract
2. Refundable contract

A declining balance contract provides a refund if the resident moves out or passes away within a certain period of time after taking residency, usually somewhere between 2-4 years. The entry fee amortizes on a declining basis by a certain percentage each year, until no refund remains. An easy example would be 25% per year for each of the first four years. After that there is no remaining refund.

Similar to a declining balance contract, a refundable contract may also amortize over the first few years, but not for the full 100%. For example, a 50% refundable contract might amortize 25% for the first two years but the remaining 50% is always refundable, no matter how long the resident lives in the community.

Generally speaking the refundable portion of the entry fee is not taxed as income when received by the resident or their heirs. But there are exceptions.

First, if a resident takes a medical expense tax deduction¹ on the entry fee it *could* cause some part of the refund to be taxed when received. Such a deduction may be available because many CCRCs use a portion of the entry fee to help offset the cost of future healthcare services. A representative of the community should be able to provide you with an estimate of the percentage of its overall operating expenses that are spent providing healthcare and it is this amount that may be deductible as a medical expense. Allowable medical expense tax deduction may range anywhere between 20-40% of the *non-refundable* portion of the entry fee. However, if a deduction is taken on any amount of the entry fee that will ultimately be refunded to the resident then that amount would likely be taxed when received.

A similar situation could even apply when someone chooses a traditional, declining balance contract. As an example, suppose a resident takes a medical expense tax deduction on the entire entry fee but ends up unexpectedly moving out or passing away sometime during the first couple of years. In this case a refund would be received in accordance with the amortization schedule and a sizable portion of the refund could be taxed.

In summary, if a resident or a resident's heirs receives any portion of a refundable entry fee that had previously been deducted then it would most likely trigger an income tax when received.

What about estate taxes?

The other area where a refundable entry fee could potentially be taxable would be in regards to a federal estate tax. A refundable entry fee is most likely going to be considered an asset of the resident(s) and, as such, could be included as part of a decedent's estate and subject to any applicable federal estate taxes. Of course, if the total value of the estate, including the refundable entry fee, does not exceed the gift and estate tax exemption, which is \$5.49 million (per person) in 2016 then this would be a non-issue. Potential estate or inheritance taxes at the state level could vary from state to state.

Disclaimer: The information presented here should not be construed as legal or tax advice. Be sure to consult with your legal and tax advisors before making any decisions regarding refundable entry fees and to better understand the possible federal and state tax implications.

¹ See IRS Pub. 502- Medical and Dental Expenses, "Lifetime Care- Advance Payments" Also refer to IRS Revenue Rulings 76-185, 75-302, 76-106, 76-481.

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