

SPECIAL ALERTS

Revised Form 1040-X

The IRS has substantially revised Form 1040-X, Amended U.S. Individual Tax Return, and instructions for tax year 2009.

Among the changes:

- The revised form has one column (a column for correct amounts) instead of three columns. Therefore, the taxpayer no longer has to compare line items, as in previous versions.
- The taxpayer must provide the Explanation of Changes at the beginning of the amended return instead of at the end.
- A detailed section on dependents is provided for taxpayers who are increasing or decreasing the number of dependents claimed on the original return.

Because prior-year tax software is generally not adjusted to accommodate new forms, the IRS is accepting the three-column version of Form 1040-X for prior years. Tax professionals and taxpayers who wish to file an amended return for 2008 or an earlier year may either 1) use the previous version of the form provided in the software program for the tax year being amended, or 2) complete the revised version of the form manually.



ERPs For Children

Children who received Supplemental Security Income (SSI) benefits during the qualifying period (November 2008, December 2008, or January 2009) received a \$250 Economic Recovery Payment last year. The ERP received by a parent or guardian for the benefit of the child, even if the parent is the payee, does not affect the parent's Making Work Pay Credit (MWPC).

In instances where an electronically-filed return is rejected because the ERP has been omitted from the taxpayer's Schedule M, some taxpayers believe that the only ERP received by the family was for a child.

However, in reviewing this situation, the IRS has found that reported cases have so far indicated that the information received from government agencies is correct. That is, the taxpayer/parent received his or her own ERP, but had either forgotten this fact or wasn't aware of the automatic deposit of the ERP made to his or her bank account. In other instances, the taxpayer's ERP may have been offset by a federal tax liability, child support, student loan, etc. so the taxpayer didn't see the money.

If a client insists that the only ERP received was for a child:

1. The client should check bank records May, 2009 through July, 2009. It is likely that the client will find out that his or her own ERP was received. For example, in one case that the IRS reviewed, the taxpayer had a child receiving SSI disability benefits but didn't realize that his own VA benefits also generated an ERP—possibly because his child's ERP was a paper check but his own payment was direct deposited.
2. If bank records don't yield any information, the client should contact the appropriate agency to find out whether an ERP was paid, and for whom.

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- a. If the client, spouse, or dependents received social security or SSI benefits, call the Social Security Administration at 1-800-772-1213
- b. If the client, spouse, or dependents received VA benefits, call the Department of Veterans Affairs at 1-800-827-1000
- c. If the client, spouse, or dependents received RRB benefits, call the Railroad Retirement Board at 1-877-772-5772

If the client believes that information sent to the IRS is incorrect, he or she must obtain documentation from the appropriate agency. For example, if the only ERP was paid on account of a child's SSI disability and the client does not receive SS, VA, or RRB benefits, the client should obtain a letter from the Social Security Administration that the ERP was for the child and no other ERP was paid from SSA. In order to receive the full MWPC, the client will have to file a paper return (original or amended) and attach all supporting documentation.

For the Tax Pro

QUESTION OF THE MONTH

Q. My client, who is legally blind, has a seeing-eye-dog. Is the cost of caring for the dog deductible as a medical expense?

A. Yes. The medical expense deduction for the diagnosis, mitigation, treatment, or prevention of disease includes the expense connected with a specially trained animal used as a guide for blind and/or deaf individuals (e.g., a seeing-eye dog).

Deductible expenses include the cost of:

- acquiring and training the animal
- training for the taxpayer to learn to work with the animal
- food, medicines, veterinary care
- harnesses and other special equipment

Caution: The animal must be certified as a trained assistance animal. However, service animals may be of any type, including dogs, cats, monkeys, birds, etc.



INSULATED SIDING DOES NOT QUALIFY FOR ENERGY CREDIT

In an information letter, the IRS explained why the purchase of insulated vinyl siding does not qualify for the §25C nonbusiness energy property credit. To qualify for the credit, an insulation material or system must be specifically and primarily designed to reduce the heat loss or gain of a dwelling unit. While insulated siding may provide some improvement to the home's heating and cooling efficiency, its primary purpose is to provide structural support or a finished surface for the home. Thus, insulated vinyl siding does not qualify for the credit.

See Federal Tax Credits for Consumer Energy Efficiency on Energy Star's web site for specifications on insulation and other home improvements that qualify for the nonbusiness energy property credit or the residential energy efficient property credit.

MEDICAL DEDUCTION FOR ALZHEIMER'S CARE

In response to a taxpayer's request, the IRS explained in INFO 2009-0252 that the monthly fee paid to an Alzheimer's medical facility is deductible.

Generally, if the medical care provided for an individual's condition is the principal reason for her presence in the institution, the cost of medical care, including food and lodging, is fully deductible as a medical expense. In the case of an individual who resides full-time in an Alzheimer's facility, it is presumed that her principal reason for being in the facility is for treatment of Alzheimer's disease. Thus the entire fee, including medical care, meals, and lodging is deductible as a medical expense.

Note: The expense must be for the taxpayer, spouse, or dependent, must not be reimbursed or reimbursable by insurance, and is subject to the 7.5% of AGI limitation.

PORTION OF SETTLEMENT EXCLUDABLE AS COMPENSATION FOR PHYSICAL ILLNESS

Court Case: *Domeny v. Comm’r*, T.C. Memo. 2010-9

In *Domeny v. Comm’r*, the Tax Court found that a portion of the taxpayer’s settlement in a wrongful termination suit was received for physical illness and was therefore excludable from income.

Background: Under §104(a)(2), gross income does not include the amount of any damages received on account of personal physical injuries or physical sickness. For purposes of this exclusion from gross income, physical sickness does not include emotional distress.

Facts: In 1996, Julie Leigh Domeny was diagnosed with multiple sclerosis (MS). The symptoms of her MS included numbness in her feet, fatigue, lightheadedness, vertigo, and sometimes a burning sensation behind her eyes. She found that it worked better for her to manage these symptoms without the prescribed medication. She sought employment in a position where she would not have to spend as much time on her feet. In 2000, the taxpayer went to work for PACE (the Pacific Autism Center for Education). She enjoyed her work with PACE and was motivated by interacting with the parents and the children involved with the program.

Some time after her employment began, PACE appointed a new executive director who was the taxpayer’s supervisor. Due to restrictions that the supervisor placed on her work, the taxpayer developed a strained relationship with the supervisor. This strain caused the taxpayer’s MS symptoms to flare up. In November, 2004, the taxpayer became aware that the director was embezzling funds from the students’ personal accounts. The taxpayer reported this to the board members of the organization and was told that they would take care of this situation. The knowledge of the embezzlement caused the taxpayer to feel more tension and stress. On many occasions, the taxpayer let her superiors know of the stress that this situation was causing her. The series of events caused the taxpayer’s MS symptoms to intensify.

On March 8, 2005, the taxpayer consulted with her doctor who determined that she was too ill to return to work until after March 21, 2005. The taxpayer faxed notification of her doctor’s orders, signed by her doctor, to PACE. The executive director of PACE then notified the taxpayer via telephone that her employment would be terminated effective March 15, 2005. After this conversation, the taxpayer’s MS symptoms spiked and included shooting pain in her legs, fatigue, burning eyes, spinning head, vertigo, and lightheadedness.

Due to the circumstances, the taxpayer contacted a lawyer to seek compensation from PACE. Her lawyer and the PACE lawyer reached a negotiated settlement agreement. In the agreement the taxpayer released numerous possible causes of action and rights. Under the agreement PACE agreed to pay a total amount of \$33,308. Of this amount, \$8,187.50 was paid to the taxpayer and reported on Form W-2 as wages, \$8,187.50 was paid to the taxpayer’s attorney and was not reported to the taxpayer at all, and \$16,933 was reported to the taxpayer on Form 1099-MISC as nonemployee compensation without any withholdings.

Discussion: The IRS argued whether or not the damages were received on account of physical injury or sickness. In order for this to be true, there must be a “direct and causal link” between the damages and the personal injury sustained. The settlement agreement did not expressly state that the damages were to compensate for the taxpayer’s physical injury or sickness. Because of this ambiguity, the court looked to the intent of the payor. The payor’s intent can be based on all of the facts and circumstances of the case, which have been detailed above.

The taxpayer sought the help of an attorney due to the stress at her job, the worsening of her illness attributed to the stressful environment, and her termination. The manner in which PACE paid out the settlement sheds light on their intent and on their recognition of the taxpayer’s claim and her medical condition. The differing tax and reporting requirements for each of the payments show PACE’s understanding that part of the compensation was not subject to tax or withholdings, but was due to physical illness.

The Tax Court found that the taxpayer proved that her work environment severely aggravated her existing MS in a manner that was both intense and of long duration. She was unable to return to work for more than a year following her termination. Accordingly, the court held that the taxpayer had shown that compensation for her physical illness was the only reason for the payment of “nonemployee compensation” of \$16,933.

Application: The \$16,933 is excluded from the taxpayer’s income because that portion of the payment was found to be compensation for the taxpayer’s physical illness (IRC §104(a)(2)).

Tip: Taxpayers should attempt to obtain a written settlement agreement that specifically provides for the amount that was paid on account of physical illness or physical injury. Otherwise, it may be necessary to address the issue in court as in this case.