



# Current Federal Tax Developments

March 20, 2023

Kaplan Financial Education

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## This Week We Look At:

Trust that was meant to be a CRAT found not to be one and attempted fix was too late and not undertaken correctly

PLR looked at whether item for consumption by infant to reduce risk of developing a condition was all or partially a medical expense

IRS produces FAQ on whether different types of health expenses qualify as medical expenses

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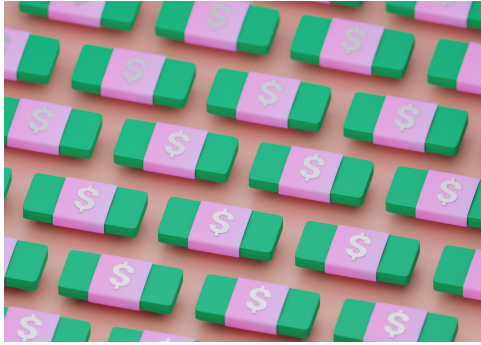


Trust that was meant to be a CRAT found not to be one and attempted fix was too late and not undertaken correctly

PLR looked at whether item for consumption by infant to reduce risk of developing a condition was all or partially a medical expense

IRS produces FAQ on whether different types of health expenses qualify as medical expenses

## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - Trust established (intended as a charitable annuity remainder trust) that provided for
    - Greater of income or \$50,000 to decedent's sister and her husband for life then
    - Balance remaining would then be transferred to a charity

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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed

- IRC §664(d)(1)(A)-(B) requirements:

(1) Charitable remainder annuity trust. For purposes of this section, a charitable remainder annuity trust is a trust--

(A) from which a sum certain (which is not less than 5 percent nor more than 50 percent of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, 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 such individual or individuals,

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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed

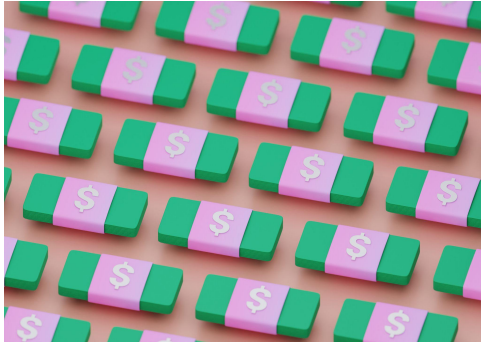
- IRC §664(d)(1)(A)-(B) requirements:

(1) Charitable remainder annuity trust. For purposes of this section, a charitable remainder annuity trust is a trust--

(B) from which no amount other than the payments described in subparagraph (A) and other than qualified gratuitous transfers described in subparagraph (C) may be paid to or for the use of any person other than an organization described in section 170(c),

<https://www.taxnotes.com/research/federal/court-documents/court-opinions-and-orders/trust-wasn%e2%80%99t-a-crata%3b-estate-denied-charitable-deduction/7g740>

## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - In a CRAT a deduction is allowed for the present value of remainder interest (in this case, for estate tax purposes under IRC §2055(a))
  - Deductions of remainder interests limited to those a qualified charitable remainder trust (IRC §2055(e)(2)(A))

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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed

(2) Where an interest in property (other than an interest described in section 170(f)(3)(B)) passes or has passed from the decedent to a person, or for a use, described in subsection (a), and an interest (other than an interest which is extinguished upon the decedent's death) in the same property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to a person, or for a use, not described in subsection (a), no deduction shall be allowed under this section for the interest which passes or has passed to the person, or for the use, described in subsection (a) unless--

(A) in the case of a remainder interest, such interest is in a trust which is a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664) or a pooled income fund (described in section 642(c)(5)), or

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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - IRC §2055(e)(3) allows a very limited chance to “fix” a drafting error of this sort
    - Applies in certain case
    - However, must be via a
      - Judicial proceeding
      - Commencing no more than 60 days after due date (including extensions) of estate tax return

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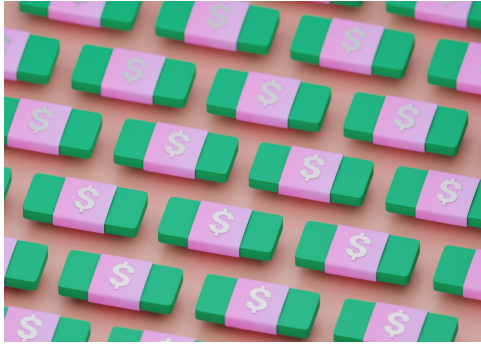
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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - After IRS exam commenced, co-trustees adopted an amendment to remove the net income reference
  - Tax Court noted that the time and method requirements, set by statute, was selected to avoid estates playing the “audit lottery” and waiting to see if the issue was raised.

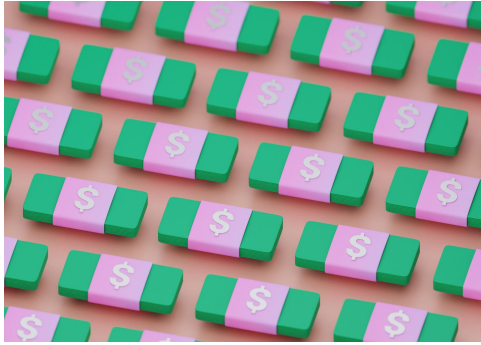
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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - Taxpayer's attempt to revise the trust was:
    - Not done in the correct manner (no judicial reformation) and
    - Not undertaken in a timely manner

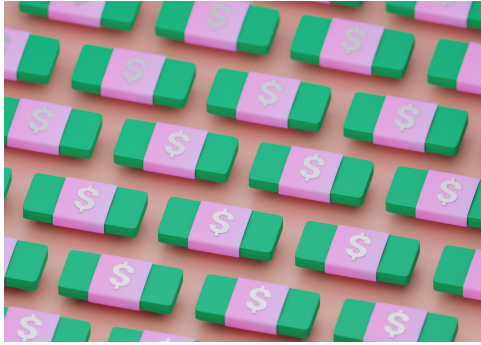
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## Provisions Cause Trust to Not Be Treated as a CRAT, Estate Tax Deduction Disallowed



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- *Estate of Block*, TC Memo 2022-30, March 13, 2023
  - The fact that the trust never had income in excess of \$50,000 nor was ever reasonably likely to have such wasn't relevant
  - Points out the importance of
    - Having an experienced attorney draft the document
    - Reviewing all such arrangements prior to the estate tax return being filed

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## Special Infant Formula Found Not to Be a Medical Expense Under IRC §



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- PLR 202311001, 3/17/23
  - Ruling looks into what qualifies as medical care for tax deduction (and FSA/HSA/HRA reimbursement) purposes

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §

IRC §213(d)(1):

(1) The term "**medical care**" means amounts paid --

**(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,**

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A),

(C) for qualified long-term care services (as defined in section 7702B(c)), or

(D) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B) or for any qualified long-term care insurance contract (as defined in section 7702B(b)).

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §



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- PLR 202311001, 3/17/23
  - Purchased product for infant to consume (formula seems likely)
    - Has specific amount of "X"
    - Taxpayer claims early introduction of "X" to diet reduces risk of "W" in the future
    - Recommended by infant's doctor
    - No known illness caused by W or imminent probability of one

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §

Section 213 (d)(1)(A) provides that medical care includes 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. The medical expense deduction has historically been construed narrowly. *Atkinson v. Commissioner*, 44 T.C. 39, 49 (1965). **Deductions for medical care have been confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness.** Section 1.213-1(e)(1)(ii) of the Income Tax Regulations.

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §

Revenue Ruling 55-261, 1955-1 C.B. 307, holds, in part, that generally, the cost of special food does not qualify as a medical expense. However, in special cases, depending upon the particular facts presented, **if the prescribed food is taken solely for the alleviation or treatment of an illness, is in no way a part of the nutritional needs of the patient, and a statement as to the particular facts and to the food prescribed is submitted by a physician, the cost of such food may be deducted as a medical expense.** Revenue Ruling 55-261 does not support a favorable ruling on Taxpayer's facts because the **infant did not have an illness**, and the Product has **nutritional value apart from its represented benefits in preventing W.**

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §

In cases holding that the cost of a special diet is deductible under § 213, the deductible amount is limited to the excess of the cost of the special diet over the cost of a normal diet. *Nehus v. Commissioner*, T.C. Memo.1994-631, *aff'd. without published opinion* 108 F.3d 338 (9th Cir.1997); *Crawford v. Commissioner*, T.C. Memo.1993-192.

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §

Specifically, the excess cost of specially prepared foods designed to treat a medical condition over the cost of ordinary foods which would have been consumed but for the condition is an expense for medical care. *Randolph*, 67 T.C. at 489; *Cohn v. Commissioner*, 38 T.C. 387, 391 (1962); *Von Kalb v. Commissioner*, T.C. Memo. 1978- 366. A taxpayer must prove what the taxpayer spent for the special diet and what the taxpayer would spend for food to satisfy normal nutritional needs. *Flemming v. Commissioner*, T.C. Memo. 1980-583.

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §



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- PLR 202311001, 3/17/23
  - Ruling holds that the amounts paid in facts given are not deductible medical expenses
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<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Special Infant Formula Found Not to Be a Medical Expense Under IRC §



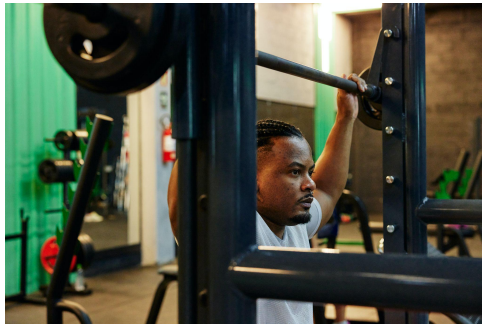
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- PLR 202311001, 3/17/23
  - What might change the result?
    - Either
      - Child actually suffered from *W or*
      - Evidence child was at imminent risk of developing *W and*
    - Evidence of extra cost of X over normal food for infant

<https://www.irs.gov/pub/irs-wd/202311001.pdf>



## Nutrition, Wellness, and General Health Payments as Medical Expenses



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- “Frequently asked questions about medical expenses related to nutrition, wellness, and general health,” IRS website, 3/17/23
  - IRS addresses certain types of expenditures and whether they qualify as medical expenses under IRC §213 or FSA/HSA/HRA reimbursement
  - Expenses for general health benefits normally don't qualify



## Nutrition, Wellness, and General Health Payments as Medical Expenses

From the FAQ:

*Medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and for the purpose of affecting any part or function of the body. These expenses include payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They include the costs of equipment, supplies, and diagnostic devices needed for these purposes. They also include the costs of medicines and drugs that are prescribed by a physician.*

*Medical expenses must be primarily to alleviate or prevent a physical or mental disability or illness. **They don't include expenses that are merely beneficial to general health.***



## **Nutrition, Wellness, and General Health Payments as Medical Expenses**

**Q1: Is the cost of a dental exam a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A1: Yes, because the dental exam provides a diagnosis of whether a disease or illness is present.

**Q2: Is the cost of an eye exam a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A2: Yes, because the eye exam provides a diagnosis of whether a disease or illness is present.

**Q3: Is the cost of a physical exam a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A3: Yes, because the physical exam provides a diagnosis of whether a disease or illness is present.



## Nutrition, Wellness, and General Health Payments as Medical Expenses

**Q4: Is the cost of a program to treat a drug-related substance use disorder a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A4: Yes, because the program treats a disease (substance use disorder).

**Q5: Is the cost of a program to treat an alcohol use disorder a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A5: Yes, because the program treats a disease (alcohol use disorder).

**Q6: Is the cost of a smoking cessation program a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A6: Yes, because the smoking cessation program treats a disease (tobacco use disorder).





## Nutrition, Wellness, and General Health Payments as Medical Expenses

### **Q7: Is the cost of therapy a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A7: Yes, if the therapy is treatment for a disease. For example, an amount paid for therapy to treat a diagnosed mental illness is a medical expense, but an amount paid for marital counseling is not.

### **Q8: Is the cost of nutritional counseling a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A8: Yes, but only if the nutritional counseling treats a specific disease diagnosed by a physician (such as obesity or diabetes). Otherwise, the cost of nutritional counseling is not a medical expense.

### **Q9: Is the cost of a weight-loss program a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A9: Yes, but only if the program treats a specific disease diagnosed by a physician (such as obesity, diabetes, hypertension, or heart disease). Otherwise, the cost of a weight-loss program is not a medical expense.



## Nutrition, Wellness, and General Health Payments as Medical Expenses

### **Q10: Is the cost of a gym membership a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A10: Yes, but only if the membership was purchased for the sole purpose of affecting a structure or function of the body (such as a prescribed plan for physical therapy to treat an injury) or the sole purpose of treating a specific disease diagnosed by a physician (such as obesity, hypertension, or heart disease). Otherwise, the cost of a gym membership is for the general health of the individual and is not a medical expense.

### **Q11: Is the cost of exercise for the improvement of general health, such as swimming or dancing lessons, a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A11: No, because the exercise, even if recommended by a doctor, is only for the improvement of general health.



## Nutrition, Wellness, and General Health Payments as Medical Expenses

### **Q12: Is the cost of food or beverages purchased for weight loss or other health reasons a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A12: Yes, but only if (1) the food or beverage doesn't satisfy normal nutritional needs, (2) the food or beverage alleviates or treats an illness, and (3) the need for the food or beverage is substantiated by a physician. The medical expense is limited to the amount by which the cost of the food or beverage exceeds the cost of a product that satisfies normal nutritional needs. If any of the three requirements is not met, the cost of food or beverages is not a medical expense.

### **Q13: Is the cost of nonprescription (over-the-counter) drugs and medicines a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A13: Yes. Except for the cost of insulin, the cost of a drug that isn't prescribed by a physician is not a medical expense that is deductible under section 213 of the Code. However, the cost of over-the-counter drugs and also menstrual care products may be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA.



## **Nutrition, Wellness, and General Health Payments as Medical Expenses**

### **Q14: Is the cost of nutritional supplements a medical expense that can be paid or reimbursed by an HSA, FSA, Archer MSA, or HRA? (added March 17, 2023)**

A14: Yes, but only if the supplements are recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a physician. Otherwise, the cost of nutritional supplements is not a medical expense.

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