Tax Reductions for Individuals with Disabilities

Prepared for the Kentucky Developmental Disabilities Council

The Martin School of Public Policy and Administration

Edward T. Jennings, Jr., Project Director

Jeremy L. Hall, Research Assistant

August 10, 2004

The following report contains information on tax reductions that are available for individuals with disabilities. A variety of tax breaks are available to help disabled taxpayers cope with the financial burdens of disability. Tax relief falls into three categories. First, many types of disability payments are exempt from taxes. Second, disabled taxpayers can deduct a number of special expenditures related to their disability. Finally, some special tax credits are available. Businesses that improve access for the disabled are also eligible for tax credits and deductions.

Payments excluded from income. Many types of payment received for disability are excluded from taxable income. These include workers compensation, VA payments, insurance payments for physical disability, and payments under an employer's health and accident plan. Damage awards for pain and suffering for personal injury are tax-free. However, awards for punitive damages or emotional distress are generally taxable. Social security disability payments are treated like all social security payments and may be taxed, depending on income.

Disability-related deductions. All taxpayers can deduct medical expenses to the extent they exceed 7.5% of adjusted gross income. Those with disabilities can deduct items such as wheelchairs, guide dogs, and special telephones. They can also deduct the cost of attending special schools or tuition to learn skills such as Braille or sign language.

Disabled taxpayers can usually deduct some or all of the cost of home improvements made to relieve their disability. This covers items such as access ramps, wider doorways, stair lifts, or even a special air filtering system.

Tax credits. A disabled taxpayer who is permanently and totally disabled is eligible for a credit of 15% of disability income, subject to various adjustments. Caregivers for a disabled taxpayer might also qualify to claim the dependent care credit.

Business tax breaks. Businesses are eligible for both special deductions and tax credits for the costs of making their premises or vehicles more accessible to the handicapped.

(Excerpts from: Internal Revenue Service, U.S. Department of the Treasury. *IRS Publication 524: Credit for the Elderly or the Disabled.* 2003. http://www.irs.gov/pub/irs-pdf/p524.pdf)

The U.S. Internal Revenue Code calls for a tax credit for the elderly or the disabled. To claim this tax credit, an individual must be:

1) Age 65 or older, or
2) Retired on permanent and total disability

In addition, the individual must meet certain income requirements to be eligible. "Retired on disability" doesn't mean that you have formally retired, necessarily. You are considered retired if you stop working because of your disability. "Permanent and total disability" means that you are not able to engage in any substantial gainful activity because of your physical or mental condition. A physician must certify that the condition has lasted or can be expected to last continuously for 12 months or more, or that the condition can be expected to result in death.

If you are under 65, you only qualify if you have taxable disability income paid through your employer's accident health plan or pension plan and if it is included in your income as wages (or payments in lieu of wages) for the time you are absent from work due to the permanent disability.

The maximum amount of this credit is $1,125. You may take the credit if:

1. You are qualified (as described above)
2. Your adjusted gross income is less than $12,500 to $25,000 (depending on your filing status), and
3. Your nontaxable income from Social Security or other nontaxable pension is less than $3,500 to $7,500 (also depending on your filing status).

(http://www.irs.gov/newsroom/article/0,,id=106798,00.html)

Excerpts from: Internal Revenue Service, U.S. Department of the Treasury. *IRS Publication 907: Tax Highlights for Persons with Disabilities.* 2003. http://www.irs.gov/publications/p907/index.html)

Dependent Care Benefits:

You can exclude from income benefits provided under your employer's qualified dependent care assistance plan. You may be able to exclude up to $5,000. The care must be provided for your dependent under the age of 13 or your spouse or dependent who is not able to care for himself or herself.

Disability Pensions:

Disability payments you receive through accident or health insurance plans paid for by your employer are counted as income. If you and your employer both pay a portion, you count as income only the part that results from your employer's payments. If you paid the entire cost of the plan, you do not count the disability payments as income.

Military and government disability pensions are not counted as income.

Benefit payments from public welfare funds, such as payments due to blindness, are not taxable income. Worker's compensation payments for occupational sickness or injury are not taxable. Compensatory (not punitive) damages for physical injury or sickness are not taxable. Disability payments under a "no-fault" car insurance policy for loss of income or earning capacity as a result of injuries are not taxable. Compensation for permanent loss of use of a part or function of your body, or for permanent disfigurement is not taxable.

Long-term care insurance contracts are generally excludable from income.

Accelerated death benefits you receive on the life of an insured individual can be excluded from income so long as certain conditions are met.

Itemized Deductions:

Individuals with disabilities may elect to take the standard deduction for individuals, or they may itemize their deductions. Such deductions include:

Medical and Dental expenses: you may deduct the portion of expenses in excess of 7.5% of your adjusted gross income. Improvements to a home that do not increase its value, such as the addition of entrance and exit ramps, may be counted as medical expenses.

You may deduct impairment-related work expenses. These are allowable business expenses for attendant care at your workplace and other expenses in connection with your workplace that are necessary for you to work.

Available Tax Credits:

Three tax credits may be of interest to individuals with disabilities: the Child and Dependent Care Credit, the Earned Income Credit, and the Credit for the Elderly or the Disabled (as described above).

Child and Dependent Care Credit. Generally, if you pay someone to care for either your dependent under age 13 or your spouse or dependent who is not able to care for himself or herself, you may be able to get a credit of up to 35% of your expenses. To qualify, you must pay these expenses so you can work or look for work.

Earned Income Credit. This credit is based on the amount of your earned income. But you can get the credit only if your earned income for 2003 was less than:

- $11,230 ($12,230 for married filing jointly) and you did not have a qualifying child,
- $29,666 ($30,666 for married filing jointly) and you had one qualifying child, or
- $33,692 ($34,692 for married filing jointly) and you had more than one qualifying child.

To figure the credit, use the worksheet in the instructions for Form 1040, 1040A, or 1040EZ. If you have a qualifying child, also complete Schedule EIC, *Earned Income Credit,* and attach it to your Form 1040 or 1040A. You cannot use Form 1040EZ if you have a qualifying child.

> *Qualifying child.* A qualifying child must be under age 19 at the end of 2003, or a full-time student under age 24 at the end of 2003, or permanently and totally disabled at any time during 2003, regardless of age.
>
> *Earned income.* If you are retired on disability, benefits you receive under your employer's disability retirement plan are considered earned income until you reach minimum retirement age. However, payments you received from a disability insurance policy that you paid the premiums for are not earned income.

Credit for the Elderly or the Disabled. (See Above)

Business Tax Incentives:

If you own or operate a business, or you are looking for work, you should be aware of three tax incentives for businesses to help persons with disabilities. They are:

1. Deduction for costs of removing barriers to the disabled and the elderly—This is a deduction a business can take for making a facility or public transportation vehicle more accessible to and usable by persons who are disabled or elderly.
2. Disabled Access Credit—This is a nonrefundable tax credit for an eligible small business that pays or incurs expenses to provide access to persons with disabilities. The expenses must be to enable the eligible small business to comply with the ADA of 1990.
3. Work Opportunity Credit—This credit provides for businesses with an incentive to hire individuals from targeted groups that have a particularly high unemployment rate or other special employment needs.

Kentucky Revised Statutes provide for tax credits as follows:

1. $20 for an unmarried individual, $40 for two married individuals filing jointly (KRS 141.020)
2. An additional $40 if the taxpayer has reached age 65 (KRS 141.020)
3. An additional $40 if the taxpayer is blind (KRS 141.020)
4. Household and Dependent Care Service Credit (20% of the federal credit allowed) (KRS 141.067)
5. Nonrefundable "low income" tax credit (KRS 141.066)

Amount of Adjusted Gross Income	Percent of Tax Liability Allowed as Low Income Tax Credit
< $5,000	100%
$5,000-$10,000	50%
$10,000-$15,000	25%
$15,000-$20,000	15%
$20,000-$25,000	5%
> $25,000	0