Baker v. Commissioner, 122 T. C. 143 (2004)

In Baker v. Commissioner, the U. S. Tax Court ruled that residents of a continuing care retirement community (CCRC) may use the percentage method to determine the deductible portion of their monthly service fees for medical care, rejecting the IRS's push for the actuarial method. This decision reaffirmed the IRS's long-standing guidance allowing the simpler percentage method, which calculates the deductible amount based on the ratio of medical to total facility costs. The ruling is significant as it provides clarity and consistency for CCRC residents in calculating medical deductions, impacting how such expenses are treated for tax purposes.

Parties

Delbert L. Baker and Margaret J. Baker, the petitioners, were residents of Air Force Village West, a continuing care retirement community, and brought the case against the Commissioner of Internal Revenue, the respondent.

Facts

The Bakers entered into a residence agreement with Air Force Village West (AFVW), a nonprofit CCRC in Riverside, California, on December 22, 1989, entitling them to lifetime residence. They resided in an independent living unit (ILU) and paid monthly service fees of $2,170 in 1997 and $2,254 in 1998. AFVW provided different levels of care, including ILU, assisted living units (ALU), special care units (SCU), and skilled nursing facilities (SNF). The Bakers claimed deductions for the portion of these fees allocable to medical care, calculated by an ad hoc committee of residents using the percentage method, and additional deductions for Mr. Baker's use of the community's pool, spa, and exercise facilities. The IRS audited their returns and initially used the percentage method based on AFVW's vice president of finance's calculations but later sought to apply the actuarial method, which the Bakers disputed.

Procedural History

The IRS audited the Bakers' tax returns for 1997 and 1998, initially determining deficiencies based on the percentage method as calculated by AFVW's vice president of finance. After the audit, the IRS sought the advice of an actuary and attempted to apply the actuarial method instead. The Bakers contested the IRS's position, leading to a trial before the U. S. Tax Court. The court's decision was based on the review of evidence presented by both parties, including financial reports and calculations using both the percentage and actuarial methods.

Issue(s)

Whether the percentage method or the actuarial method should be used to determine the deductible portion of monthly service fees paid by residents of a continuing care retirement community for medical care under section 213 of the

Internal Revenue Code?

Whether the Bakers are entitled to additional deductions for Mr. Baker's use of the pool, spa, and exercise facilities at the retirement community?

Rule(s) of Law

Section 213(a) of the Internal Revenue Code allows deductions for expenditures for medical care, subject to certain limitations. The Commissioner's guidance in Revenue Rulings 67-185, 75-302, and 76-481 has sanctioned the use of the percentage method for determining the deductible portion of fees paid to a retirement home for medical care.

Holding

The Tax Court held that the Bakers were entitled to use the percentage method to determine the deductible portion of their monthly service fees for medical care, resulting in deductions of $7,766 for 1997 and $8,476 for 1998. The court rejected the IRS's argument for using the actuarial method. Additionally, the court held that the Bakers were not entitled to additional deductions for Mr. Baker's use of the pool, spa, and exercise facilities.

Reasoning

The court reasoned that the percentage method has been consistently accepted by the Commissioner since at least 1967 and provides a straightforward approach for calculating the deductible portion of fees based on the ratio of medical to total costs. The actuarial method, while potentially more precise, was deemed overly complex and not required by the existing revenue rulings. The court also noted that the percentage method directly links the fees paid to the medical costs incurred by the CCRC during the taxable year, whereas the actuarial method involves estimating lifetime costs, a step not anticipated by the revenue rulings. Regarding the deductions for the use of recreational facilities, the court found that the Bakers did not provide sufficient evidence to substantiate the medical necessity of these expenses or to allow for a rational estimate of the deductible amount.

Disposition

The court upheld the use of the percentage method for calculating the deductible portion of the Bakers' monthly service fees and denied additional deductions for the use of the pool, spa, and exercise facilities. The decision was entered under Rule 155 of the Tax Court Rules of Practice and Procedure.

Significance/Impact

This case reaffirmed the use of the percentage method for determining medical expense deductions for residents of CCRCs, providing clarity and consistency in tax treatment. It rejected the IRS's attempt to impose a more complex actuarial method, thus maintaining the status quo in how such deductions are calculated. The decision impacts the tax planning of CCRC residents and may influence future IRS guidance on similar issues. It also highlights the importance of maintaining clear and substantiated records when claiming medical expense deductions, particularly for expenses related to recreational facilities.

