

## Medicaid Waiver Payments

*This is a high consequence item and we see on the order of 20 returns of this type in District 7 every year. EIC can be about \$3300 per child.*

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## Background

2021 NTTC PUB 4012, page D-7 has a brief introduction on the MWP program.

A 2019 Tax Court case (*Feigh v. Commissioner (2019)*, 152 TC No. 15) was settled in favor of the plaintiff to allow MWP to be treated as earned income for purpose of calculating Earned Income Credit (EIC) and Additional Child Tax Credit (ACTC). MWP continues to be non-taxable income per IRS Notice 2014-7. We are allowed to amend all open tax years to claim the additional credits.

IRS Notice 2014-7 was issued to allow MWP to be excluded from gross income, thus making it non-taxable. The IRS Notice cited existing law to treat the MWP as “difficulty of care payments” under § 131 and to allow the MWP to be non-taxable. Although not specifically stated in the IRS Notice, the IRS maintained that if the MWP was not included in gross income then it could not be used for the EIC and ACTC. The 2019 Tax Court ruled that the IRS had no authority to reclassify a taxpayer’s income through a Notice such that the taxpayer was being denied these credits that were established under existing congressional law.

Subsequently and quietly, the IRS changed Form 1040 Instructions to allow the MWP to be used as earned income for EIC and ACTC calculations. This was done for 2018 to present.

The IRS website has a Q&A titled “Certain Medicaid Waiver Payments May Be Excludable From Income” that provides additional background.

## Portal Resources

- Training Slide 13 - Income Medicaid Waiver COMP TY21 Rel 1.
- NTTC Training Video – Medicaid Waiver on W-2 dated 9/25/20  
<https://www.youtube.com/watch?v=me6X9YWpHqw>  
Provides instructions for TaxSlayer entry with various income sources including MWP. Covers only a W-2 input, but the process is similar for a 1099.
- 2021 NTTC PUB 4012, page D-7 Entering Medicaid Waiver Payments
- Medicaid Waiver Payments Guide - Medicaid Waiver *Difficulty of Care* Payments, dated 10/4/2021 – TaxSlayer entry guide

## NTTC PUB 4012 Instructions

The version of the PUB we used for the 2020 tax year was Release 2A dated 2-5-2021. The Release 2A said to take all the MWP to the W-2 input screen.

The 2021 NTTC PUB 4012 Release 1 dated 11-1-2021 has improved instructions for the MWP on page D-7 with a hyperlink to the “Medicaid Waiver Payments Guide”. This Guide has detailed instructions for entering MWP along with the instructions to test for the best scenario.

A significant change from previous year’s instructions is to take the following general approach:

1. Always enter the MWP on the wages line (Line 1) of Form 1040 using the W-2 input screen regardless of how reported to the taxpayer. This is done when it is beneficial to include the MWP in earned income for EIC/ACTC. This also follows the Form 1040 instructions per NTTC direction. Then test the various scenarios to maximize the credits and refund.
2. If a Form 1099-MISC or 1099-NEC is received, it should be entered on the 1099-MISC Box 3 input screen and also subtracted (backed-out) to provide a more positive method to allow the IRS matching/auditing of documents. Hopefully, this will deflect IRS mismatch letters. In order to subtract the 1099-MISC entry, there are two ways this can be done. 1) On the 1099-MISC entry screen enter the amount of the MWP in the Medicaid Waiver Payment \$ Field and do not check the earned income box OR 2) Use the Less Common Income / Other Income Not Reported Elsewhere and enter description as “Notice 2014-7” and enter the amount as the negative of the 1099-MISC entry. Then enter the MWP as directed by step 1 above.

**CAUTION:** When subtracting the 1099-MISC entry make sure that there are no unwanted results when using option 1) above. I am not sure exactly where TaxSlayer takes the MWP entry on all tax forms and worksheets. You may need to use option 2).

My advice for a more complex return, with MWP reported on a 1099 and other earned and unearned income sources, is to enter the MWP using the W-2 entry along with all other inputs. Then test and maximize the benefits such that the return is complete. Then make the 1099-MISC Box 3 entry and back-out and verify the return is unchanged by the 1099 entry.

It should be noted that TaxSlayer has the same MWP boxes on both the W-2 and 1099-MISC input screens such that the desired result may be obtained by either entry method. However, the NTTC guidance is to enter the MWP as earned income using the W-2 input as described above.

## Additional Child Tax Credit & Child Tax Credit – 2021 Changes

Prior to 2021, how the MWP was entered could have an impact on the refundable ACTC. The 2021 changes make the CTC fully refundable under most situations and this seems to override the refundable ACTC from prior years. It is possible for a family to have both an adult disabled child (18 or older) and a child under 18 that qualifies for the CTC. The Form 8812 and Instructions do account for MWP in the Earned Income Worksheet (Line 4.d) found in the Instructions. This seems very complicated and we will likely have to rely on TaxSlayer to properly perform this calculation with the prescribed entry and testing methods. Currently, Practice Lab has not updated for the 2021 rules.

## Other Dependent Credit

If the adult disabled child is claimed as a dependent, they will normally qualify for the nonrefundable Other Dependent Credit (\$500). This credit is also calculated in the Form 8812 for 2021.

## TaxSlayer Software Inputs

TaxSlayer 2019, 2020, and 2021 software added boxes to assist in completing either a W-2 or 1099-MISC input for MWP and testing in the various scenarios to maximize the credits and refund.

Follow the instructions from 2021 NTTC PUB 4012 and the “Medicaid Waiver Payments Guide” as described above.

**CAUTION:** The 2017 and 2018 TaxSlayer software does not have these same boxes and requires manual entry and manipulation to properly add as earned income and deduct for non-taxable income (with reference to IRS Notice 2014-7). On the W-2 input, there is a box for “Medicaid Waiver Payments in Box 1”. An entry in this box will subtract the amount from income and apply the IRS Notice 2014-7, all on Line 21, but it will not be included as earned income in the EIC calculation. **Therefore, do not use this box when amending a 2017 or 2018 return.**

Suggested Training Video: NTTC Training Video – Medicaid Waiver on W-2 9/25/20  
<https://www.youtube.com/watch?v=me6X9YWpHqw>

It may be useful to review the EIC Graph that shows the relation between Earned Income/AGI and resulting EIC. Keep in mind that EIC is dependent upon either Earned Income or AGI, whichever gives the lower amount. The EIC will increase or decrease as one moves up and down the graph based on either Earned Income or AGI.

These are the two boxes that you will use to input MWP on both the W-2 and 1099-MISC input screens in TaxSlayer:

Do you want to include Medicaid Waiver payments in the calculation of earned income?

Medicaid Waiver Payment

\$

These inputs do different things within TaxSlayer depending upon if the input is a W-2 or 1099-MISC Box 3. Generally, the following happens:

- Checking the box, adds or keeps the MWP in the EIC calculation.
- Entering a value in the Medicaid Waiver Payment \$ field, subtracts the MWP from gross income and lowers AGI. For the 1099-MISC input, this also automatically transfers this amount to Schedule 1, Part I, Line 8, Other Income, as a negative number with the “Notice 2014-17” automatically added to Line 8. This also generally removes the amount entered from the EIC calculation if the above box is not checked.

Keep in mind that an entry in W-2 Box 1 Wages is treated as earned income as the starting point. An entry from a 1099-MISC Box 3 Other Income, is as unearned income as the starting point. This directly affects how the above MWP entries alter the tax return.

It is recommended to test the return using the four combinations of the boxes – see the NTTC Training Video and the “Medicaid Waiver Payments Guide”.

### Income Reporting Sources

The most common MWP is reported on a 1099-MISC from the Idaho Department of Health and Welfare. These are typically reported in Block 6, Medical and Health Care Payments, and need to be moved to Block 3, if using the 1099-MISC input in TaxSlayer.

The MWP may be reported on a W-2 and may be from a 3<sup>rd</sup> party payer. The W-2 payer may have an unfamiliar name and the Social Security and Medicare withholding blocks will normally be blank. There may or may not be tax withholding. These W-2s are confusing and should prompt a question to the taxpayer – they will know that these are MWP since they had to go through a certification process to be a Certified Family Home and qualify for MWP.

In either situation, **the key is to ask if they are a Certified Family Home.**

Unusual example from the last year. Taxpayer received MWP from two sources:

1. W-2 from “Consumer Direct Fiscal Vendor” Missoula, MT. The SS & Medicare fields were all blank but did have a little federal tax withheld.
2. 1099-MISC Block 6, Medical and Health Care Payments, from IDH&W Division of Medicaid

## Support and Dependency

An adult disabled child typically receives Supplemental Security Income (SSI). The SSI is not part of the Social Security system and is considered as support provided by the State rather than the child. The child may also receive Social Security Disability Income (SSDI) and this comes from and is treated as Social Security - If a child receives Social Security benefits and uses them toward their own support, the benefits are considered as provided by the child. SSDI eligibility for taxpayer's adult child is: Your unmarried child, age 18 or older, and has a disability that started before age 22. The child's disability must also meet the definition of disability for adults.

The Certified Family Home rules require all CFH residents to pay their CFH provider a monthly room and board charge as negotiated in the CFH certification agreement. This would typically come from the child's SSI, SSDI, and/or W-2 sources.

MWP is income earned by the parents and is treated as support provided by the parents.

It is likely that you have or will come across a discussion of whether or not the adult disabled child can be claimed as a dependent. Some of the parents receiving MWP have stated the State Health and Welfare representatives have told them that they cannot claim the adult disabled child as their dependent. Additionally, some paid preparers and CPAs also maintain that the adult disabled child cannot be claimed as a dependent. It is believed this is simply misinformation or is a carry-over from the pre-2009 definition of a dependent in which the taxpayer had to provide  $> \frac{1}{2}$  the child's support. The current tax law does not require the taxpayer to provide  $> \frac{1}{2}$  support, but rather the child does not provide  $> \frac{1}{2}$  of their support. A subtle but important difference. The adult disabled child must also meet all other tests to be a dependent in addition to the support test.

The 2020 Economic Impact Payments (EIP) also threw a potential complication in the issue of dependency. Some adult disabled children (probably dependents) were advised to file their own return as a taxpayer for 2019 and/or 2020 to claim their EIP #1 (\$1200) and #2 (\$600). EIP was not to be allowed if the adult disabled child could be claimed as dependent. In some of these situations in 2020 (right or wrong?), we filed with the adult disabled child as a "qualifying child for Earned Income Credit" and not a dependent – see below. In such cases, we cautioned the family that there might be issues with their EIP or EIC based on the MWP. This should not be an issue for EIP #3 (\$1400) in TY 2021, as adult dependents were eligible with the EIP #3 going to the parent of the claimed dependent.

In the situation where the adult disabled child does in-fact provide  $> \frac{1}{2}$  their own support from whatever sources including W-2 earned income, it is possible for the parents to claim the child as a "qualifying child for Earned Income Credit" (trifold Box 30) – support is not a test for EIC. With the MWP, the parents may get a large EIC. In this case you must not also allow the adult disabled child to get EIC based on their own earned income. The adult disabled child may be required to file a return or should file their own return possibly just to get any withholding or EIP, if applicable. The child is

listed on the parents return, but mark the box that the child is not being claimed as dependent.

The method to prevent the child from getting EIC on their return is as follows:

In the TaxSlayer Form Finder box (top left) type in “EIC Checklist” and then go to the EIC Checklist now. This brings you to the EIC Due Diligence Checklist (remember this from a few years ago!). You must answer the following two question as YES:

- 1) Is the taxpayer (the disabled adult child) a qualifying child of another person?
- 2) Is the taxpayer (the disabled adult child) eligible to be claimed as a dependent on anyone else’s federal income tax return?

Verify the EIC is eliminated and the **DOES NOT QUALIFY** is shown in the summary screen.

## Idaho Considerations

- Be aware of the Idaho \$100 credit for maintaining a home for a family member with a developmental disability. For these MWP scenarios, often the child is developmentally disabled as defined in the Idaho code. The taxpayer must maintain the household and provide > ½ the support for the family member. The Idaho Form 40 Line 44 Instructions state that the taxpayer can also claim this for themselves or their spouse if they meet the disability and support requirements.
- Also be aware of the exception to paying the Line 32 Permanent Building Fund of \$10. This is not required if you are receiving Idaho public assistance. Public assistance includes aid to dependent children, general assistance, old-age assistance, aid to the blind, aid to the disabled and medical assistance. WIC and food stamps (SNAP) do not qualify as public assistance for this purpose. MWP should qualify as public assistance as aid to dependent children. In order to delete the \$10 Permanent Building Fund on the return, go to the Idaho return Main Menu – Basic Information – Permanent Building Fund and select YES for “were you receiving Idaho public assistance payments”.

## Amending Returns

Refer to the 2021 NTTC PUB 4012 instructions for the MWP on page D-7 and the “Medicaid Waiver Payments Guide” as discussed above. The approach contained in the 2021 instructions and guide should be followed for prior year amendments rather than using the NTTC PUB for those years. The 2021 documents are now better aligned with IRS instructions.

*From IRS Q&A #10 - Certain Medicaid Waiver Payments May Be Excludable From Income:*

*To help expedite the processing of your amended return, you should include the following to substantiate your claim:*

*(1) the full name of the individual receiving care (and the care recipient’s social security number or other taxpayer identifying number, if available);*

- (2) copies of documents from third parties to show that you and the individual receiving care resided in the same home in the year to which the claim relates (such as a driver's license or other government-issued document, social agency document, bank statement, medical bill, or utility bill); and*
- (3) evidence that the individual is receiving care under a state Medicaid waiver program.*

Lessons Learned: Based on IRS letters that were received this summer by some taxpayers who filed amended returns, we need to do a better job of addressing these 3 items, especially (2) and (3) for "evidence". There seems to be inconsistency in how these amended returns are processed by the IRS. Some were processed quickly with refunds issued and others resulted in the IRS letters asking for additional information.

## **Homework and In-Class Exercise**

Use the 2021 NTTC Workbook Focused Exercise for John Adams.

Original Solution

Head of Household

25-year-old disabled daughter claimed as dependent and eligible for ODC.

Unearned Income: Interest \$266 + Unemployment \$3250 = \$3516

Earned Income (W-2) = \$30,500

AGI = \$33,989

ODC = \$500

EIC = \$1308 and is based on the AGI – see EIC Graph

Refund = \$4096

MWP Exercise

In the Personal Information Section, delete the check box for Taxpayer elects to use their 2019 earned income.

Treat the W-2 from Walker Construction as a Medicaid Waiver Payment received on a W-2. Delete the Box 12 D \$1000 entry. This deletes the \$100 Retirement Savers Credit.

Refund = \$3996

Check the Box to include MWP as earned income on the W-2 – no change to refund. TaxSlayer already considers this as earned income.

Enter the W-2 amount \$30,500 in MWP \$ Field

Refund increases to \$5584

AGI = \$3489 with the MWP subtracted from Gross Income

ODC = \$0 (no tax liability)

EIC increases to \$1859 and is based on Earned Income of \$30,500 – you will need to print the return to see the EIC Worksheets to see this.

Test the last scenario to remove the check mark in the Box to include MWP as earned income – this reduces the earned income to zero

Refund decreases to \$3725 which is the withholding

AGI remains unchanged at \$3489

ODC = \$0 (no tax liability)

EIC goes to zero because there is no earned income

If you go back to the original scenario and check the box In the Personal Information Section to use their 2019 earned income and enter \$29,950 as the 2019 earned income, you will see the following when continuing the above exercise.

Refund increases to \$5672

AGI remains unchanged at \$3489

ODC = \$0 (no tax liability)

EIC = \$1947 and this is now based on the 2019 earned income of \$29,950 which is larger than the 2021 earned income at this point in the exercise.

You will need to print the return to see the EIC Worksheets to see this.

Finally, leaving the return as-is for the exercise, consider the MWP as being received on a 1099-MISC. Add a 1099-MISC Box 3 entry of the MWP = \$30,500 and also enter the \$30,500 in the Medicaid Waiver Payment \$ field in order to subtract this amount. Verify the refund and EIC remain the same.