

Income and Tax Withholding Exemptions Detailed Information & Action Steps

Difficulty of Care payments exempt as Income

The first applies to a gross income exemption for caregivers who live with the person they care for through the Medicaid waiver. The Difficulty of Care exemption exempts income from caring for a person living in the same home from being included as Gross Income.

- **Highlights:**

1. If the "provider of care" lives with the recipient of care, then their income is NOT part of their gross income.
2. This applies if the "provider of care" is the parent or a non-related person.
3. This is not OPTIONAL - if this applies to you, you are legally required to exempt this income from your gross income

- **Action Steps:**

1. If you are the paid "provider of care" for a Medicaid waiver recipient in your home, sign the attached "Statement of Eligibility for "Difficulty of Care" Exemption".
2. Turn in the signed statement to the agency completing payroll for the recipient.
3. File "Form 1040X, Amended U.S. Individual Income Tax Return" for 2014 and 2015, if the living arrangement was the same at that time. (see Q10 & A10 below).
 - You will adjusting your gross income as described below A11.
 - This will result in an adjustment of taxes, deductions, and credits.

Links to pertinent documents, and relevant excerpts

Excerpts from Notice 2014-7 Difficulty of Care payment exemption (<https://www.irs.gov/pub/irs-drop/n-14-07.pdf>)

This notice provides that certain payments received by an individual care provider under a state Medicaid Home and Community-Based Services Waiver (Medicaid waiver) program, described in this notice, are difficulty of care payments excludable under § 131 of the Internal Revenue Code.

Treatment of qualified Medicaid waiver payments under § 131

- To achieve consistent federal tax treatment of Medicaid waiver payments among the states and individual care providers, this notice provides **that as of January 3, 2014, the Service will treat qualified Medicaid waiver payments as difficulty of care payments** under § 131(c) that are excludable under § 131, and **this treatment will apply whether the care provider is related or unrelated to the eligible individual.**
- For purposes of this notice, qualified **Medicaid waiver payments are payments made** by a state or political subdivision thereof, or an entity that is a certified Medicaid provider, **under a Medicaid waiver program to an individual care provider for nonmedical support services** provided under a plan of care to an eligible individual **(whether related or unrelated) living in the individual care provider's home.**
- Therefore, an eligible individual receiving care under a Medicaid waiver program lives in a "foster family home" because the eligible individual is a qualified "foster" **individual who receives care in a "family home" setting**, as opposed to an institution, **where the individual care provider also resides.**
- Medicaid waiver payments made to a provider for care **outside of the home where the provider resides are not qualified Medicaid waiver payments and are not excludable under § 131.**
- Section 131(d)(2) provides that a provider may not exclude payments for the care of more than 10 eligible individuals under age 19 or more than five eligible individuals who are age 19 or over.

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EFFECTIVE DATE

- This notice is effective for payments received on or after January 3, 2014.

Excerpts from Certain Medicaid Waiver Payments May Be Excludable From Income

(<https://www.irs.gov/individuals/certain-medicaid-waiver-payments-may-be-excludable-from-income>)

- Individual care providers who receive Medicaid waiver payments for the care of eligible individuals in their homes and payers of Medicaid waiver payments have raised several questions not addressed in Notice 2014-7.
- The following questions and answers clarify the notice and provide guidance on the information reporting requirements, and the employment tax requirements for Medicaid waiver payments described in the notice.

Individual Care Provider Questions

- Q5. I am the parent of a disabled child, and I receive state Medicaid Home and Community-Based waiver payments excludable from gross income under Notice 2014-7 for the care of my child in our home. My sister lives with me, and she also receives state Medicaid Home and Community-Based waiver payments for the care of my child. May she exclude the Medicaid waiver payments from gross income?
- A5. **Yes. More than one care provider living in the home with the care recipient** may exclude state Medicaid Home and Community-Based waiver payments from gross income under Notice 2014-7.
- Q8. I am an individual care provider, and I receive vacation pay from the state, as well as Medicaid waiver payments for the care that I provide to a disabled individual living in my home under the individual's plan of care. May I exclude the vacation pay from gross income?
- A8. No. The only amounts excludable from gross income under Notice 2014-7 are payments for the care of the disabled individual.
- Q9. I received payments described in Notice 2014-7 on or after January 3, 2014, that are excludable from gross income as difficulty of care payments under § 131. May I choose to include those payments in my gross income for 2014 and later years?
- A9. **No. A taxpayer may not choose to include in gross income difficulty of care payments** that are excludable from gross income under § 131 as provided in Notice 2014-7.
- Q10. If I received payments described in Notice 2014-7 in an earlier year, may I file an amended return to exclude the payments from gross income that I reported as income in the earlier year?
- A10. **Yes. You may file a Form 1040X**, Amended U.S. Individual Income Tax Return, if you received payments described in the notice in an earlier year and the time for claiming a credit or refund has not expired under § 6511 of the Internal Revenue Code. **A taxpayer generally may file a claim for refund within three years from the date the return was filed or two years from the date the tax was paid, whichever is later.** For more information, see "When To File" in the instructions to Form 1040X or Tax Topic 308, Amended Returns, available at <http://www.irs.gov/taxtopics/tc308.html>. **In Part III of Form 1040X, you should explain that the payments are excludable under Notice 2014-7. Excluding payments described in the notice in an earlier year may affect deductions or credits that you claimed for the earlier year, as well as other tax items for the earlier year.** 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.
- Q11. I received wage payments that are excludable from gross income under Notice 2014-7. However, the agency that pays me treats me as an employee and continued to withhold federal income tax on the payments and reported the payments as wages in box 1 of Form W-2, Wage and Tax Statement. How should I report to the Service that the payments are excludable from gross income?

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- A11. If you are not able to obtain a Form W-2c, Corrected Wage and Tax Statement, from the agency reporting the correct amount in box 1 of Form W-2, you should include the full amount of the payments reported in box 1 of Form W-2 as wages on line 7 of Form 1040. You should then subtract the excludable portion of the amount in box 1 on line 21 "Other income," of Form 1040. If you have other income reportable on line 21, you should enter the net amount after subtracting the amount excludable from gross income under Notice 2014-7 from the other amounts reportable on line 21. You may need to enter a negative amount on line 21 if you have no other income reportable on line 21, or if the amount of other income you must report on line 21 is less than the amount excludable from gross income. You should write "Notice 2014-7" on the dotted line for line 21 if you file a paper return, or enter "Notice 2014-7" on line 21 for an electronically filed return.
- Q12. I receive payments that are excludable from gross income under Notice 2014-7. Are the payments subject to **social security and Medicare taxes under the Federal Insurance Contributions Act (FICA)**?
- A12. Maybe. Whether the payments are subject to social security and Medicare taxes depends on whether you are an employee of the agency, an employee of the individual care recipient...
- If the agency is your employer, the payments are subject to social security and Medicare taxes. See Q&A 18 under Agency Questions.
 - If the care recipient is your employer and these payments are wages for that employment, the payments are subject to social security and Medicare taxes unless one of the exceptions for domestic services applies. See Q&A 19 under **Agency Questions**.

If you believe social security and Medicare taxes were withheld in error from your payments, such as because one of the exceptions for domestic services applied, **you must first contact the agency that withheld the taxes for a refund**. However, if the agency indicates an intention not to file a claim or adjust the overpaid social security and Medicare taxes, **you may claim a refund of the erroneously withheld social security and Medicare taxes by filing Form 843, Claim for Refund and Request for Abatement**. The requirements for filing a claim for refund of your share of social security and Medicare taxes can be found in the Instructions for Form 843.

Agency Questions

- Q15. As an agency that is a certified Medicaid provider, I make payments under a state Medicaid Home and Community-Based Services waiver program. **What information should I request from individuals who claim the payments they receive are excludable from gross income under Notice 2014-7?**
- A15. If you do not have independent knowledge that the payments you make are excludable from gross income under Notice 2014-7, **you may rely on a written statement by the payee, signed under penalties of perjury, unless you know that the statement is not true. The statement should affirm the facts you need to determine that Notice 2014-7 applies to the payee. For example, a statement may be worded as follows:**
- Under penalties of perjury, I declare that I am an individual care provider receiving payments under a state Medicaid Home and Community-Based Services waiver program for care I provide to _____ who lives in my home under the care recipient's plan of care.*
- Signed: Date:*
- Q16. I am an agency that employs individuals who provide care to disabled individuals under a state Medicaid Home and Community-Based Services waiver program. Some of the payments I make are excludable from the employee's gross income under Notice 2014-7. **Am I required to withhold federal income tax** on the payments that are excludable under Notice 2014-7?
- A16. **No. Federal income tax should not be withheld from the payments that are excludable from gross income** under Notice 2014-7.
- Q17. How do I **complete the Form W-2, Wage and Tax Statement**, that I provide to my employees who receive payments excludable from income under Notice 2014-7?

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- A17. Any amount excludable from gross income should not be included in box 1, Wages, tips, other compensation, of the employee's Form W-2. If the entire amount you pay to the employee during the year is excludable from his or her gross income, **box 1 of Form W-2 should be left blank.**
- Q19. I pay individual care providers to care for disabled individuals and properly treat the care providers as employees of the care recipients. I fulfill the employment tax responsibilities for the care recipient. If the payments I make to the care providers on behalf of the care recipients are excludable from gross income under Notice 2014-7, **am I required to withhold and pay social security and Medicare taxes on the payments?**
- A19. Maybe. Although payments you make to the care providers as employees of the care recipients may be excludable from gross income for federal income tax purposes, those payments are generally wages for social security and Medicare tax purposes.
- However, there are several important exceptions to this rule.**
- **If the care recipient is the employer** of the individual care provider, the FICA tax rules for domestic service (household work done in or around the employer's home) will apply.
 - Under those rules, payments for services performed for a spouse or a child and services performed for a parent by a child under the age of 21 generally are not subject to social security and Medicare taxes.
 - In addition, if wages for domestic services paid during a calendar year are below a threshold (\$1,900 for 2014), they are not subject to social security and Medicare taxes.
 - See Publication 926 for more information on these exceptions.
 - **If you withheld and paid social security and Medicare taxes in error because you did not correctly apply one of these exceptions, see the Instructions for Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund.**