Are you caring for aging parents?

If so, you'll want to know about the adult dependent exemption

If you're in your 40s or 50s, it's time to face the facts: Your parents are likely reaching the age where you may have to help them physically and financially. At the same time, you may be raising your own children or paying for their college education. And if that isn't enough of a concern, you also need to fund your own retirement. The combination of these factors can create a substantial burden on your finances. To help ease the monetary strain, you may be able to take advantage of the adult dependent tax exemption. The question is whether you qualify.

Is your parent considered a dependent?

The adult dependent tax exemption allows qualifying taxpayers to deduct up to $3,650 (in 2010) for each adult dependent claimed. So how do you qualify? It's all about income — yours and that of the parent in question.

First, for your parent to be considered a dependent, his or her income must be less than $3,650 (in 2010). Social Security generally doesn't count toward this amount, though any income from sources such as dividends, interest and 401(k) withdrawals does.

Second, you must contribute more than 50% of your parent's financial support. Here Social Security is a factor in that the amount your parent receives may detract from how much you're contributing. For example, your parent may receive less than $3,650 in income, but if he or she is using Social Security to pay for medicine or other items, you may not be providing enough support to claim the exemption.

On the bright side, if your parent lives in your home, you can factor the fair market rental value of your residence into how much financial support you're providing. However, your parent does *not* have to live with you for you to claim the exemption. If he or she stays in a separate residence, or lives in a nursing home or assisted living facility, you can still factor your financial support into the 50% test.

What if you don't qualify?

If you don't qualify for the exemption because your parent has too much income, you may not be out of luck. You may still be able to deduct combined medical costs that you pay for a parent and your own family in excess of 7.5% of your adjusted gross income.

Another alternative to consider is whether you have a dependent-care Flexible Spending Account (FSA). If you do and you hire someone to provide care for your live-in parent while you're working, you may pay up to $5,000 of the costs with pretax dollars via your FSA.

Last, don't forget about the child and dependent care tax credit. It allows you to claim a percentage of your total care costs based on your income level and other factors. The credit may let you reduce your tax liability, dollar for dollar, by as much as 35% of $3,000 (or $6,000) of your costs, depending on the number of children or dependents. Ask your tax advisor for details.

Relief is available

You love your parents and will do anything for them as they grow older. But providing for them, combined with supporting your children and preparing for your own retirement, can strain your finances. Thus, it's important to take advantage of all available financial help. One option is long-term care insurance.

"Does long-term care insurance make sense?"

Even if your aging parents have a health insurance policy, it likely doesn't cover assisted living arrangements, nursing home residence and long-term care. Many people purchase long-term care (LTC) insurance because it can cover a broad range of medical, skilled-nursing and nonmedical services.

LTC policies typically require a short waiting period, similar to a health care insurance policy's deductible amount. In addition, these policies offer a daily or monthly maximum monetary benefit or a maximum period (in years) for which they'll cover expenses.

The cost of annual LTC insurance premiums depends on the insured's age and the coverage amount he or she purchases. The younger your parents are when they buy their policy, the lower the monthly premium. But keep in mind that the earlier your parents start their coverage, the longer they're likely to pay premiums. And similar to life insurance, they must purchase LTC insurance before they actually need it. Those who already are chronically ill will have a difficult time obtaining a policy.

After deciding on buying an LTC insurance policy, your parents can choose from an individual or group plan. Briefly, an individual plan typically offers more comprehensive coverage and greater benefits options, but the plan is more expensive. A group plan generally is less expensive and easier to qualify for, but offers fewer options because benefits are less flexible.

Be sure to consult with your Salmon Sims Thomas tax advisor to determine whether you qualify for the adult dependent tax exemption.