

MEDICAL EXPENSES: AN EXPANSION OF THE CONCEPT OF  
"INSTITUTION"

KELLY v. COMMISSIONER, 440 F.2d 307 (7th Cir. 1971)

While in New York City on a business trip, taxpayer Kelly suffered an appendicitis attack and underwent emergency surgery. Though still convalescing from the operation, he was forced to leave the hospital because of its pressing need for space. Kelly had not recovered sufficiently to return to his home in Milwaukee and, following his doctor's advice, he stayed in a hotel room until he was able to travel. Though the hotel furnished no medical services to Kelly,<sup>1</sup> he did receive nursing care from his wife, as well as attention from his doctor at the latter's office.<sup>2</sup> Kelly deducted his hotel bill, consisting of meals and lodging, as a medical expense under § 213 of the Internal Revenue Code of 1954.<sup>3</sup> The deduction was disallowed by both the Commissioner and the Tax Court.<sup>4</sup> On appeal to the United States Court of Appeals for the Seventh Circuit, the Tax Court's decision was reversed and the deduction allowed.<sup>5</sup> *Held*: The hotel qualified under Treasury Regulation § 1.213-1(e)(i)(v)<sup>6</sup> as an "institution" whose charges for meals and lodging were

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1. Daniel S.W. Kelly, 231 P-H Tax Ct. Mem. 1310, 1312 (1969). The hotel physician did attend to Kelly on one occasion, but his fee was paid directly to him, not to the hotel.

2. *Id.* Because of inadequate nursing facilities at the hospital, Kelly's wife came to New York to assist with her husband's post-operative care. She lacked formal nursing training, but was able to give medication, change bandages, and perform other such functions. Kelly visited his physician in his office four times during his eight days at the hotel.

3. INT. REV. CODE OF 1954, § 213: MEDICAL, DENTAL, ETC., EXPENSES:

(a) Allowance of Deduction. There shall be allowed as a deduction the following amounts, not compensated for by insurance or otherwise—

(1) the amount . . . paid during the taxable year . . . for medical care of the taxpayer . . . .

(e) Definitions—For purposes of this section—

(1) The term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment or prevention of disease, or for the purpose of affecting any structure or function of the body . . . ."

4. Daniel S.W. Kelly, 231 P-H Tax Ct. Mem. 1310 (1969).

5. Kelly v. Commissioner, 440 F.2d 307 (7th Cir. 1971).

6. Treas. Reg. § 1-213-1(e)(i)(v) (1957):

. . . (v) The cost of in-patient hospital care (including the cost of meals and lodging therein) is an expenditure for medical care. The extent to which expenses for care in an institution other than a hospital shall constitute medical care is primarily a question of fact which depends upon the condition of the individual and the nature of the services he receives (rather than the nature of the institution). A private establishment which is regularly engaged in providing the types of care or services outlined in his subdivision shall be considered an institution for purposes of the rules provided herein. In general, the following rules will be applied:

(a) Where an individual is in an institution because his condition is such that the

deductible medical expenses.<sup>7</sup>

The court found that Kelly had received sufficient medical care and that his only reason for being in the hotel was the availability of these services. The court rejected the proposition that a facility could not qualify as an "institution other than a hospital" under the Regulation unless it was regularly engaged in providing medical services. The "primary test of deductibility" depended upon "the condition of the individual and the nature of the services he receives (rather than the nature of the institution)."<sup>8</sup> The court reasoned that the facts of the case presented the type of "real hardship situation" which § 213 was intended to compensate.<sup>9</sup>

Section 213 of the Internal Revenue Code allows the taxpayer to deduct as medical expenses amounts paid during the taxable year for "medical care" for himself, his spouse, and his dependents.<sup>10</sup> Thus expenditures for the services of doctors, dentists and nurses, as well as for medicines, are clearly deductible.<sup>11</sup> The Code and the Regulations also

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availability of medical care (as defined in subdivisions (i) and (ii) for this subparagraph) in such institution is a principal reason for his presence there, and meals and lodging are furnished as a necessary incident to such care, the entire cost of medical care and meals and lodging at the institution, which are furnished while the individual requires continual medical care, shall constitute an expense for medical care. For example, medical care includes the entire cost of institutional care for a person who is mentally ill and unsafe when left alone. While ordinary education is not medical care, the cost of medical care includes the cost of attending a special school for a mentally or physically handicapped individual, if his condition is such that the resources of the institution for alleviating such mental or physical handicap are a principal reason for his presence there. In such a case, the cost of attending such a special school will include the cost of meals and lodging, if supplied, and the cost of ordinary education furnished which is incidental to the special services furnished by the school. Thus, the cost of medical care includes the cost of attending a special school designed to compensate for or overcome a physical handicap, in order to qualify the individual for future normal education or for normal living, such as a school for the teaching of braille or lip reading. Similarly, the cost of care supervision, or of treatment and training of a mentally retarded or physically handicapped individual at an institution is within the meaning of the term "medical care".

7. Judge Fairchild dissented, stating that only those institutions regularly furnishing medical services can qualify under the regulation. 440 F.2d 307, 312 (7th Cir. 1971).

8. Treas. Reg. § 1.213-1(e)(1)(v) (1957).

9. 440 F.2d 307, 311 (7th Cir. 1971).

10. See note 3 *supra*.

11. Treas. Reg. § 1.213-1(e)(1)(ii) (1957):

Thus, payments for the following are payments for medical care: hospital services, nursing services (including nurses' board where paid by the taxpayer), medical, laboratory, surgical, dental and other diagnostic and healing services, X-rays, medicine and drugs (as defined in subparagraph (2) of this paragraph, subject to the 1-percent limitation in paragraph (b) of this section), artificial teeth or limbs, and ambulance hire.

See 5 A.J. MERTENS, LAW OF FEDERAL INCOME TAXATION, § 31A.08a (J. Malone ed. 1971).

provide for the deduction of certain expenses which would otherwise be considered nondeductible personal living expenses under § 262.<sup>12</sup> For example, transportation costs, incurred "primarily for and essential to medical care" are deductible.<sup>13</sup> Likewise, the expenses of meals and lodging for a patient at a hospital are allowable deductions.<sup>14</sup>

It is also clear that under some circumstances "expenses for care in an institution other than a hospital," including meals and lodging, can constitute medical care under Treasury Regulation § 1.213-1(e)(1)(v).<sup>15</sup> Deductions under this Regulation have been sought for meals and lodging at schools, nursing homes, hotels and apartments. An examination of the cases in each of these areas reveals that the courts have approached the question of the services provided by the facility as a threshold issue which must be answered before the other requirements of the Regulation are considered.

Schools, treating children's mental and physical deficiencies, have been the subject of frequent litigation.<sup>16</sup> Two common issues arise in those cases: (1) whether the function of the school is primarily medical or educational and (2) whether the medical services furnished were "a

12. INT. REV. CODE of 1954, § 262; PERSONAL, LIVING, AND FAMILY EXPENSES. Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

(V) Cross references—Certain items of a personal, living, or family nature are deductible to the extent expressly provided under the following sections, and the regulations under those sections:

(6) Section 213—(medical, dental, etc., expenses.) Treas. Reg. § 1.262-1(b)(5) (1960).

13. INT. REV. CODE of 1954, § 213; MEDICAL DENTAL, ETC. EXPENSES:

(e) Definitions.—for purposes of this section—

(1) The term "medical care" means amounts paid—

(B) for transportation primarily for and essential to medical care . . . .

The Supreme Court has held that under the 1954 Code, the expenses of food and lodging at the destination of a prescribed trip are not deductible, *Commissioner v. Bilder*, 289 F.2d 291 (3d Cir.), cert. denied, 368 U.S. 499 (1961), although such costs were allowed under § 23(x) of the 1939 Code, *Stringham v. Commissioner*, 12 T.C. 580, aff'd, 183 F.2d 579 (6th Cir. 1950) (per curiam). See Treas. Reg. § 1.213-1(e)(1)(iv) (1957). The *Kelly* court distinguished *Bilder*, since transportation expenses were not at issue on appeal.

14. See note 6 *supra*.

15. See note 6 *supra*. The regulation first sets out general guidelines and then specific rules to be applied when the "principal reason" test is satisfied [(§ 1.213-1(e)(1)(v)(a))] and when it is not [(§ 1.213-1(e)(1)(v)(b))].

16. See, e.g., Paul T. Ripple, 54 T.C. 1442 (1970); Israel J. Weinberg, P-H Tax Ct. Mem. 1969-3; Arnold P. Grunwald, 51 T.C. 108 (1968); C. Fink Fischer, 50 T.C. 164 (1968); Edward S. Enck, P-H Tax Ct. Mem. 1967-058; Reuban A. Baer, P-H Tax Ct. Mem. 1967-034; H. Grant Atkinson, Jr., 44 T.C. 39 (1965); Rolland T. Olson, P-H Tax Ct. Mem. 1964-325; Hobart J. Hendrick, 35 T.C. 1223 (1961); Everett Glaze, P-H Tax Ct. Mem. 1961-244; Rev. Rul. 280, 1958-1, CUM. BULL. 157.

principal reason" for the child's presence at the school. The court will not reach these issues if it finds that the school does not regularly furnish medical services. Thus in the leading case of *Martin J. Lichterman*,<sup>17</sup> the Tax Court disallowed the deduction of tuition, meals and lodging at a school in Arizona to which the taxpayer's son was sent for health reasons. The court, finding no medical services were provided by the school, stated: "The regulations provide, however, that a private establishment, in order to be considered as a qualifying institution, must be regularly engaged in providing types of care or services referred to in the regulations."<sup>18</sup>

The courts have followed a similar approach in dealing with cases seeking deductions for nursing home expenditures.<sup>19</sup> A showing that a principal reason for being in the institution is to receive the medical care provided by that facility is required. While "a primary reason" is the most frequently litigated issue, the courts will decide that issue only after an examination of the sufficiency of the services rendered by the nursing home.

Prior to *Kelly*, there was little authority for allowing a deduction of meals and lodging at apartments or hotels under § 1.213-1(e)(1)(v). In *Robert M. Rose*,<sup>20</sup> a taxpayer sought a deduction for the expense of maintaining his daughter in the dust-free environment of a Florida motel to treat her allergy to house-dust. The girl's mother provided nursing care; in addition, the room was equipped with plastic furniture upholstery, allergenic pillows and mattress covers, and a vapor spraying machine. The Tax Court held, *inter alia*, that a private establishment, to qualify under § 1.213-1(e)(1)(v), must be regularly engaged in providing medical services.<sup>21</sup> Thus the Regulation would not apply to a motel room.

Hotel meals and lodging apparently would have been allowed as de-

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17. 37 T.C. 586 (1961).

18. *Id.* at 595. The Tax Court has recently reaffirmed the principles of *Lichterman* in Paul T. Ripple, 54 T.C. 1442 (1970), in which meals and lodging were not allowed as deductions because the school to which the taxpayer had sent his son was not a qualified school under the regulation. In determining the primary function of the school, the court noted, "It must be established that the tuition was paid for services *provided by the . . . school* which . . . were primarily medical in nature rather than educational." (Emphasis added), 54 T.C. 1442, 1447.

19. *See, e.g.*, John Robinson, 51 T.C. 520 (1968), *aff'd*, 422 F.2d 873 (9th Cir. 1970) (court denied deduction, finding no nursing facilities provided); W.B. Counts, 42 T.C. 755 (1964) (deduction allowed; taxpayer's father required constant nursing attention, which was provided by the nursing home); James J. Matles, P-H Tax Ct. Mem. 1964-248; Rev. Rul. 185, 1967-1 Cum. Bull. 70.

20. 52 T.C. 521 (1969), *aff'd per curiam*, 435 F.2d 149 (5th Cir. 1970).

21. *Id.*

ductible medical expenses in *Cohn v. United States*,<sup>22</sup> if the taxpayer had not made an error in pleading. He had sought to deduct expenses incurred while at a hotel connected to the Mayo Clinic. The hotel provided nursing care and hospital facilities. Though he had alleged the availability of treatment facilities at the hotel, the taxpayer's motion for summary judgment was denied because he had failed to allege that he had used the facilities.<sup>23</sup>

In ruling on the applicability of § 1.213-1(e)(1)(v) to different factual situations, courts have uniformly considered the furnishing of medical services by the private establishment to be a prerequisite to a deduction. *Kelly's* significance lies in its express rejection of this interpretation of the Regulation. The court correctly notes that the regulation "does not state that *only* such an establishment, [furnishing medical services] may ever be an "institution" within the meaning of the regulation."<sup>24</sup> The court appears to be implicitly criticizing the Commissioner for drafting a regulation that does not say what he had intended.<sup>25</sup> The court then adopts as "the primary test of deductibility" the condition of the individual and the services he receives. Since *Kelly's* condition required medical services and the care he received was "medical care", the only remaining issue was whether "a principal reason" for his presence at the hotel was to receive the medical services. The question of who furnished the services was of no importance. The court will allow the deduction if the medical services are merely *accessible at* the institution, rather than *available from* the institution.

While it is possible to distinguish *Kelly* on its facts as a case involving "a real hardship situation," many future taxpayers will doubtless attempt to use *Kelly* as support for medical expense deductions of meals and lodging in other contexts. For example, the court's analysis would appear to allow a deduction for the cost of meals and lodging at the home of a friend while convalescing, provided "a principal reason" for the person's presence at the home was the accessibility of medical ser-

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22. 240 F. Supp. 786 (D. Ind. 1965).

23. *Id.* at 790.

24. 440 F.2d 307, 311 (7th Cir. 1971).

25. The court was apparently influenced by *Kelly's* argument that the regulation, as written, contains many inconsistencies which obscure its meaning. "The language [of the regulation] does not say—as the court below appeared to assume—that *only* institutions regularly engaged in providing medical care shall be 'institutions' for purposes of the regulations. Had this result been intended, insertion of the word "only" would have easily and unambiguously achieved it. To infer the exclusion of all other types of institutions flies in the face of the language immediately preceding. . . ." Brief for Appellee at 10-11, *Kelly v. Comm.*, 440 F.2d 307 (7th Cir. 1971).

vices. In school cases, it could be argued from *Kelly* that the absence of medical services at the school would not require disallowance. It would suffice that "a principal reason" for the child's presence at the school was the availability of treatment from outside physicians, if, in addition, the condition of the individual required the treatment and he actually received it. Similarly, to claim a deduction for nursing home expenses, it would no longer be necessary to prove that the home furnished any services.

The validity of the court's approach can best be judged by examining the purpose of the Commissioner in promulgating § 1.213-1(e)(1)(v). The regulation recognized the existing practice of allowing a patient in a hospital to deduct the costs of meals and lodging. It was no doubt felt that fairness required a similar deduction for a person in a facility comparable to a hospital, though not so named. The regulation's application was intended to be restricted to those "institutions" which furnished services similar to those of a hospital.<sup>26</sup> Thus the Commissioner stressed the medical services that must be supplied by the facility. In rejecting the apparent narrow scope of the regulation, the court has opened the way for a potential flood of litigation under a now expanded § 1.213-1(e)(1)(v).

As noted above, it will be possible for future courts to restrict the *Kelly* holding to its particular facts and thus avoid any major extension of the regulation's deductions. If this is the case, *Kelly* will perhaps best be remembered for its admonition to the Commissioner to draft his regulations with specificity sufficient to limit their application to only those situations intended.

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26. The only expansion of the regulation approved prior to *Kelly* was the Tax Court's decision in *Sidney J. Ungar*, P-H Tax Ct. Mem. 1968-868 in which it was held such a "hospital environment" justified a deduction. In order to provide his ailing mother with better, but less expensive, care than the hospital could offer, Ungar rented a small apartment in the building where he lived, equipped it with medical facilities, and engaged nursing care for his mother, as well as regular visits from her doctor. In allowing the deduction, the court reasoned, "It [the expense of the apartment] was unlike the expense of lodging during a period of convalescence and was quite similar to room rent in a hospital during an acute stage of illness." p. 871. The basis of the decision distinguishes it from *Kelly*, which clearly involved a convalescence. In addition, *Kelly* did not allege that his hotel room duplicated a hospital environment and consequently the *Kelly* court did not rest its decision on that ground. The Tax Court, in *Robert M. Rose*, 52 T.C. 521 (1969), without citing *Ungar*, reserved the question whether it might be possible for an individual to find or create living quarters completely unrelated to any established institution providing medical care, but which substantially duplicates hospitalization. Thus, even the narrow exception set out in *Ungar* may now be subject to doubt.