**SB 6**

# Department of Legislative Services
2015 Session

## FISCAL AND POLICY NOTE

Senate Bill 6 (Senator Klausmeier)
Budget and Taxation

### Income Tax - Credit for Long-Term Care Premiums

This bill alters the existing one-time long-term care insurance income tax credit by allowing the credit to be claimed for every year a policy is in force. In tax years 2016 and 2017, individuals can claim a maximum credit of $250 for each year the policy is in effect; the maximum amount in each year is increased to $500 beginning in tax year 2018. The changes in the credit are only applicable to policies issued after December 31, 2015.

The bill takes effect July 1, 2015.

## Fiscal Summary

**State Effect:** General fund revenues increase by $1.2 million in FY 2017, which reflects a net decrease in the amount of credits claimed as a result of decreasing the value of the credit in the first tax year. General fund revenues decrease beginning in FY 2018 reflecting additional losses from allowing the credit to be claimed in successive years and increases in the value of the credit specified by the bill. No impact on expenditures.

| ($ in millions) | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
|---|---|---|---|---|---|
| GF Revenue | $1.2 | ($0.5) | ($6.0) | ($8.9) | ($11.9) |
| Expenditure | 0 | 0 | 0 | 0 | 0 |
| Net Effect | $1.2 | ($0.5) | ($6.0) | ($8.9) | ($11.9) |

*Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect*

**Local Effect:** None.

**Small Business Effect:** Minimal.

## Analysis

**Current Law:** For federal income tax purposes, individuals may deduct or otherwise exclude from income eligible long-term care insurance premiums. These federal tax benefits reduce federal adjusted gross income, which in turn will also generally reduce State and local taxes by flowing through to Maryland adjusted gross income. In addition, the State also provides additional tax benefits as discussed below.

*Federal Tax Benefits*

The federal Health Insurance Portability and Accountability Act of 1996 established favorable tax treatment for long-term care insurance similar to that granted to accident and health insurance premiums. Premiums are treated as unreimbursed medical expenses that are potentially deductible from income along with other unreimbursed medical expenses. As such, if an individual itemizes deductions, the premiums are deductible to the extent that the individual's uncompensated medical expenses generally exceed 10% of the individual's adjusted gross income. Premiums may also qualify for pre-tax reimbursements plans such as Health Savings Accounts.

The value of these tax benefits is subject to the annual limitations described in Section 213 (d)(10) of the Internal Revenue Code. The maximum premium amounts under federal guidelines for tax year 2014, based on the age of the insured, are $370 for age 40 or younger, $700 for ages 41 to 50, $1,400 for ages 51 to 60, $3,720 for ages 61 to 70, and $4,660 for ages 71 and over. These amounts are indexed according to the annual increase in the medical cost component of the Consumer Price Index.

Federal tax law also provides for the deductibility of employer-paid long-term insurance premiums under certain guidelines.

*State Tax Benefits*

Chapter 242 of 2000 allows taxpayers to claim a one-time credit against the State income tax for 100%, not to exceed $500, of the eligible premiums paid for long-term care insurance for coverage of the individual or the individual's spouse, parent, stepparent, child, or stepchild. The credit may not be claimed by more than one taxpayer with respect to the same insured individual and can only be claimed on behalf of a State resident. In addition, the credit may not be claimed with respect to an insured individual if (1) the insured individual was covered by long-term care insurance at any time before July 1, 2000, or (2) the credit has been claimed by any taxpayer for any individual's long-term care insurance policy in any prior taxable year. Any unused amount of the credit may not be carried forward to any other tax year.

In addition, Chapter 7 of 1998 created a tax credit equal to 5% of an employer's cost for providing long-term care insurance benefits to employees. The credit is capped at $5,000 or $100 per employee covered. This credit may be used by an employer against the public service company franchise tax, the insurance premium tax, or individual and corporate income taxes.

**Background:** Long-term care typically provides for the medical, social, personal, and supportive services needed by people who have lost some capacity for self-care because of a chronic illness or condition. This includes services provided by nursing homes, hospices, and at-home care but does not include medical care for acute conditions. The population of long-term care recipients includes the elderly, the functionally and developmentally disabled, and individuals suffering from mental disorders such as dementia and Alzheimer's.

Due to the aging of the population, long-term care utilization is expected to increase significantly in the near future. The Kaiser Commission on Medicaid and the Uninsured estimated that of the $169 billion in long-term care spending in 2005, a little less than three-quarters was for nursing home expenditures. A recent University of Pennsylvania study noted that the heavy burden on governments to finance long-term care has prompted proposals to make long-term care more affordable through tax incentives. The study concluded that the effectiveness of these proposals in stimulating long-term care insurance depended on the availability of Medicaid and the price elasticity of the insurance. The study concluded that subsidies had a modest impact on increasing the total number of policies purchased; reducing the cost of insurance by one-half was estimated to increase the number of long-term care insurance policies by less than 5%.

The number of returns claiming the existing tax credit and the number and amount of credits claimed are listed in **Exhibit 1**.

**Exhibit 1**
**Long-term Care Insurance Tax Credits**
**2000-2013**

| Tax Year | Returns | Credits | Amount Claimed ($ in Millions) | Average Credit Claimed |
|---|---|---|---|---|
| 2000 | 2,537 | 3,658 | $1.6 | $442 |
| 2001 | 5,185 | 7,032 | 3.0 | 433 |
| 2002 | 8,691 | 12,367 | 5.1 | 409 |
| 2003 | 12,756 | 18,964 | 8.4 | 445 |
| 2004 | 6,221 | 10,238 | 4.5 | 442 |
| 2005 | 8,470 | 11,751 | 5.3 | 447 |
| 2006 | 6,192 | 8,210 | 3.6 | 440 |
| 2007 | 6,089 | 7,778 | 3.3 | 431 |
| 2008 | 5,172 | 6,735 | 2.9 | 426 |
| 2009 | 5,081 | 6,527 | 2.7 | 421 |
| 2010 | 5,098 | 6,546 | 2.8 | 428 |
| 2011 | 5,729 | 7,527 | 3.3 | 437 |
| 2012 | 5,014 | 6,553 | 2.9 | 442 |
| 2013 | 5,239 | 6,753 | 2.9 | 427 |
| **Total** | **87,474** | **120,639** | **$52.3** | **459** |

In addition to reporting data on the amount of credits claimed in each year, the Comptroller's Office is required to report the savings under the State medical assistance program as a result of additional individuals being covered by long-term care insurance as a result of the credit. The report states that although the additional number of individuals who are covered by insurance as a result of the credit is unknown, little if any savings to the State are likely at this point.

**State Revenues:** The bill alters the existing tax credit in tax years 2016 and 2017 by allowing individuals to claim a maximum credit of $250 for each year the policy is in effect and not just $500 in the first tax year as provided under current law. Beginning in tax year 2018, a taxpayer may claim a maximum credit of $500 for each year the policy is in effect. These changes are applicable to individuals who were not covered by long-term care insurance at any time before January 1, 2016. As a result, general fund revenues will increase by an estimated $1.2 million in fiscal 2017. State revenues will decrease beginning in fiscal 2018 as revenue losses from allowing the credit to be claimed in each year the policy is in effect are greater than revenue gains resulting from the decrease in the value of the credit in the first year. This estimate is based on the following facts and assumptions:

- It is estimated that, under current law, a total of $3.0 million in credits will be claimed beginning in tax year 2016 and increase by about 1.5% annually thereafter.
- An average credit of $431 was claimed in tax years 2009 through 2013 – it is assumed that the maximum credit of $250 will be claimed in tax years 2016 and 2017, and that the average amount of the credit will be claimed in 2018 with 1% annual growth thereafter.
- The price elasticity of long-term insurance policies is estimated to be -0.1.
- The estimated number of policies in force in successive years is based on the renewal rates of long-term care insurance policies as reported by the Society of Actuaries.

Allowing the credit to be claimed in every year in which the policy is in effect will substantially increase long-term revenue losses resulting from the credit. For example, Oregon and New York allow taxpayers to claim the credit in a similar manner proposed by the bill. Taxpayers will claim an estimated $75 million in tax credits in New York and $19 million in Oregon, compared with an average of $3 million in Maryland. The amount of credits claimed in these states, adjusting for differences in the value of credits, population, age, and other factors which influence the likelihood to claim the credit, suggest that over the long-term the bill will result in over $20 million in credits claimed on an annual basis.

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## Additional Information

**Prior Introductions:** Similar bills were introduced in the 2011 through 2014 sessions. SB 478 of 2014 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 778 of 2014 received a hearing in the House Ways and Means Committee, but no further action was taken. SB 23 of 2013 and SB 35 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. The cross files, HB 578 of 2013 and HB 347 of 2012, received a hearing in the House Ways and Means Committee, but no further action was taken. SB 618 and SB 703 of 2011 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 562 of 2011 received a hearing in the House Ways and Means Committee, but no further action was taken.

**Cross File:** None.

**Information Source(s):** Comptroller's Office, Internal Revenue Service, Kaiser Commission on Medicaid and the Uninsured, New York State Division of the Budget, Oregon Department of Revenue, Society of Actuaries, University of Pennsylvania, Department of Legislative Services

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