SB 170

Department of Legislative Services

Maryland General Assembly
2000 Session

FISCAL NOTE

Senate Bill 170 (Senator Hollinger, *et al.*)
Budget and Taxation

Income Tax - Credit for Long-Term Care Insurance Premiums

This bill creates a credit against the individual income tax for 25% of the premiums paid for long-term care insurance by an individual for coverage of the individual or the individual's spouse, parent, stepparent, child, or stepchild. The credit may not exceed $100 for each insured for whom an individual pays the premiums. This credit does not affect the tax treatment of any deduction allowed under federal law for long-term care premiums.

The bill also requires the Comptroller, beginning on December 1, 2005, and each year thereafter, to report to the Governor and the General Assembly regarding the credit, including: (1) the number of individuals who have claimed the credit, the amount allowed as credits, and the additional number of individuals covered by long-term care insurance as a result of the credit; and (2) the savings under the State's medical assistance program as a result of additional individuals being covered by long-term care insurance as a result of the credit.

The bill is effective July 1, 2000, and applies to all taxable years beginning after December 31, 1999.

Fiscal Summary

State Effect: General fund revenues would decline by an estimated $5.2 million in FY 2001. Out-year estimates reflect increasing growth rates throughout the period; averaging around 7% a year.

(in millions)	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
GF Revenues	($5.2)	($5.6)	($5.9)	($6.3)	($6.8)
GF Expenditures	0.0	0.0	0.0	0.0	0.0

Net Effect	($5.2)	($5.6)	($5.9)	($6.3)	($6.8)

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

Local Effect: None. This credit is only available against the State individual income tax.

Small Business Effect: Minimal.

Analysis

Current Law: See below.

Background: 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. Employee-paid 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 exceed 7.5% of the individual's adjusted gross income. This deduction is subject to an annual limitation based on the policyholder's age. The 1997 limitations are shown below. Future limitations will be adjusted for inflation using the medical care component of the Consumer Price Index.

Age Before the Close of the Tax Year	Limitation
40 or less	$ 200
More than 40, but not more than 50	375
More than 50, but not more than 60	750
More than 60, but not more than 70	2,000
More than 70	2,500

In addition, employer-paid premiums are fully excludable from employee income. However, the benefits an employer provides under a long-term care insurance contract are not tax exempt to an employee if they are provided through a "cafeteria" plan. The State Employee Health Benefits Plan is an example of a "cafeteria" plan.

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 financial institutions franchise tax, the insurance premium tax, or

individual and corporate income taxes. If the tax credit exceeds the taxes due for any taxable year, the credit can be carried forward for up to five tax years. This tax credit applies to all tax years beginning January 1, 1999.

In 1996, approximately 4.96 million long-term care insurance policies were sold. Policies are sold as an individual plan, through a group association plan, an employer-sponsored plan, or as a rider to a life insurance policy. Approximately 80% of all policies purchased were individual/group association plans. Another 13% represented employer-sponsored plans and 7% were sold as riders to life insurance policies. The average age of purchasers of individual/group association plans is around 64. Employer-sponsored plans tend to include younger policyholders (average age: 43).

According to the Health Insurance Association of America, in 1996, the average premium of individual and group policies was about $1,400, while the premiums for employer-sponsored plans were between $250 and $300. The majority of employer-sponsored plans are employee-pay plans.

Generally, long-term care policies have not been very attractive because the policies tend to be costly and the benefits were limited. Policy prices, however, appear to be declining and some plans are offering a broader array of covered services.

From 1988 through 1994, the State Employee Health Benefits Plan offered a long-term care insurance policy. The plan covered nursing homes, home health benefits, adult day care, and respite care. During that period, less than 1,000 employees subscribed to the long-term care plan.

State Revenues: General fund revenues would decline by $5.2 million in fiscal 2001 based on the following facts and assumptions:

- About 47,320 policies will be in effect in Maryland in tax year 2000. These policies represent individual or group association plans or policies that are included as a rider to a life insurance plan. The average age of these policyholders is 64, and the average cost of these policies is $1,425.

- About 6,599 additional individuals will hold policies through employer- provided benefits packages in tax year 2000. The average age of these policyholders is 43 and the average employee contribution to these policies is $275.

- The number of long-term plans issued is expected to increase each year but the cost

is expected to remain constant or to decline over time.

Total premiums paid by Maryland taxpayers in 2000 will be about $69.2 million. All individuals purchasing policies on their own will receive a $100 credit, since 25% of the average cost is $356. The average credit for policies purchased through employer- sponsored benefits plans will be $69. Thus, this credit would result in a general fund revenue loss of $5.2 million. This loss will be realized in fiscal 2001, when 2000 tax returns are filed. The loss in the out-years will grow between 7% and 8% during the relevant period. The revenue loss will be greater to the extent that this bill provides an incentive for taxpayers to purchase these policies. Any such effect cannot be estimated at this time, but is expected to be minimal.

State Expenditures: The Office of the Comptroller advises that it would incur one-time computer programming costs of $52,000 to change the tax processing system to allow for this credit. The Department of Legislative Services advises that economies of scale regarding computer programming changes could be realized, since there will be changes to the income tax process system due to the 1997 income tax reduction which is phased in through 2002.

While this bill could cause more individuals to purchase long-term care policies, which could therefore reduce Medicaid expenditures for nursing home or home care, any such effect is long term and cannot be reliably estimated. These savings would occur almost entirely in the future, whereas the revenue losses would be realized immediately.

In addition, a 1997 report by the Department of Legislative Services concluded that, in order to offset the revenue lost by granting this credit to individuals who are already purchasing or will purchase long-term care policies, sales of long-term care policies would have to increase by 50% over and above current growth of sales. It is unlikely that a 7% reduction in price ($100 tax credit applied against a $1,425 policy) could lead to a 50% increase in policies sold, and it is therefore unlikely that this bill would provide a net benefit to the State, even over the long run.

Additional Information

Prior Introductions: Similar bills, SB 29 of 1997, SB 639 of 1998, and SB 157 of 1999, each received an unfavorable report from the Senate Budget and Taxation Committee.

Cross File: None.

Information Source(s): Comptroller of the Treasury (Bureau of Revenue Estimates), Health

Insurance Association of America, American Council of Life Insurance, Department of Legislative Services

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cm/jr

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