Department of Legislative Services

Maryland General Assembly
2004 Session

FISCAL AND POLICY NOTE

Senate Bill 79 (Senator Haines)
Budget and Taxation

Income Tax - Credit for Long-Term Care Premiums

This bill expands the existing Long-Term Care Insurance income tax credit by eliminating the restrictions that in order to claim the credit: (1) the insured individual cannot have been covered by long-term care insurance at any time before July 1, 2000; and (2) the tax credit must not have been claimed for the insured by any taxpayer for any prior taxable year.

The bill takes effect July 1, 2004 and applies to all taxable years beginning after December 31, 2003.

Fiscal Summary

State Effect: General fund revenues would decline by an estimated $42.1 million beginning in FY 2005. Out-year revenues decline by 14% based on annual growth in new policies.

($ in millions)	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
GF Revenue	($42.1)	($48.3)	($55.1)	($62.6)	($70.9)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($42.1)	($48.3)	($55.1)	($62.6)	($70.9)

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

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

Small Business Effect: Minimal.

Analysis

Current Law: Maryland taxpayers are allowed a credit against the income tax for up to $500 for 100% of the 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 any taxpayer more than once for any individual's long-term care insurance policy. The maximum amount of the credit depends on the age of the insured. Based on federal guidelines, the maximum credit allowed for tax year 2003 is (1) $250 if the insured is 40 years old or younger; (2) $470 if the insured is age 41 to 50; and (3) $500 if the insured is 51 years or older. The maximum credit allowed is adjusted annually and any unused credit cannot be carried over to any other tax year.

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 (1) the elderly; (2) the functionally and developmentally disabled; and (3) individuals suffering from mental disorders such as dementia and Alzheimer's.

Long-term care can be expensive. The average annual cost of a Maryland nursing home stay in 2001 was approximately $60,000. The State currently incurs substantial long-term care expenditures. For example, the Governor's proposed fiscal 2005 budget includes about $864 million for nursing homes. This amount includes $432 million in federal fund expenditures.

Due to a rapidly aging population, State expenditures on long-term care have been projected to increase. In response to these projected spending increases, Chapter 242 of 2000 established a one-time tax credit for the purchase of new long-term care policies in an attempt to promote purchases of new long-term care policies. The credit applies to tax years 2000 and later. The amount and number of returns that have claimed the credit are listed below.

Tax Year	Returns	Amount
2000	2,673	$1,625,238
2001	5,204	$3,274,753
2002	8,998	$5,117,509

Chapter 242 of 2000 also mandated that the Comptroller report the following information about the tax credit: (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. This information is to be reported annually by the Comptroller, beginning on December 1, 2005.

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 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 tax years 1999 and beyond.

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 2003 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	$250
More than 40, but not more than 50	470
More than 50, but not more than 60	940
More than 60, but not more than 70	2,510
More than 70	3,130

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.

In addition, the federal Long-Term Care Security Act of 2000 offered the option of enrolling in long-term care insurance to most federal and U.S. postal service employees and retirees as well as active members of the uniformed services.

Currently, 25 states either offer a tax credit or tax deduction for long-term care insurance. Maine offers both a credit and a deduction.

State Revenues: This bill expands the existing tax credit in two ways: (1) policies issued prior to July 1, 2000 will now be able to claim the tax credit; and (2) for any policy in effect, the credit may be claimed for every year the policy is in effect and not just one-time as provided under current law. As a result of these changes, general fund revenues would decline by an estimated $42.1 million beginning in fiscal 2005 based on the following facts and assumptions:

- About 57,500 policies are in force that were issued prior to July 1, 2000. These policies will claim approximately $26.5 million annually beginning in fiscal 2005.
- From tax year 2000 through 2002, 16,875 taxpayer returns claimed the one-time credit for a total of approximately $10 million. These taxpayers will be eligible for the expanded credit beginning in fiscal 2005 and would claim approximately $10 million annually.
- For tax years 2003 and beyond, it is assumed that there will be a 10% annual growth in the number of taxpayers that claim the credit. Because it is assumed that each taxpayer will continue to claim the credit each year thereafter, there would be a cumulative effect resulting in revenue declines of approximately 14% per year.

Legislative Services advises that growth rates for the long-term care insurance market are difficult to forecast because of the (1) large potential market for long-term care insurance policies and relatively low market penetration rates; (2) limited data on the existing tax credit; and (3) relatively undeveloped long-term care insurance business model. To the extent that policy issuance growth rates exceed 10%, the decline in general fund revenues will increase.

This bill will have no direct effect on State expenditures.

Additional Information

Prior Introductions: None.

Cross File: None.

Information Source(s): AARP, Comptroller's Office, Health Insurance Association of America, National Conference of State Legislatures, Department of Legislative Services

Fiscal Note History: First Reader - January 26, 2004
ncs/mdr

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