Department of Legislative Services
Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 716 (Senator Hollinger, *et al.*)
Budget and Taxation

Income Tax - Credit for Long-Term Care Premiums

This bill expands the existing Long-Term Care Insurance income tax credit by allowing individuals who were covered by long-term care insurance at any time before July 1, 2000 to claim the credit. The bill allows the credit to be claimed for every year a policy is in force in the amount of $500 in the first year the credit is claimed and $100 every year after.

The bill takes effect July 1, 2006 and applies to tax year 2006 and beyond.

Fiscal Summary

State Effect: General fund revenues could decrease by approximately $34.8 million in FY 2007, which reflects the estimated number of taxpayers who were covered by insurance before July 1, 2000 claiming the credit for $500 and taxpayers who claimed the credit in tax year 2000 through 2005 claiming an additional credit of $100. Future years reflect estimated number of taxpayers claiming an additional $100 credit. No effect on expenditures.

($ in millions)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	($34.8)	($13.6)	($14.7)	($15.8)	($16.7)
Expenditure	$0	$0	$0	$0	$0
Net Effect	($34.8)	($13.6)	($14.7)	($15.8)	($16.7)

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

Local Effect: None.

Small Business Effect: Minimal.

Analysis

Current Law: Chapter 242 of 2000 allowed taxpayers to claim a credit against the State income tax for no more than $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 more than once for any individual's long-term care insurance policy. Any unused amount of the credit may not be carried forward to any other tax year.

Eligible long-term care premiums are as defined under Section 213 (d)(10) of the Internal Revenue Code. The maximum premium amounts under federal guidelines for tax year 2006 based on the age of the insured are: (1) $280 (40 years old or younger); (2) $530 (age 41 to 50); (3) $1,060 (age 51 to 60); (4) $2,830 (age 61 to 70); and (5) $3,530 (age 71 and over). These amounts are increased according to the annual increase in the medical component of the Consumer Price Index for all urban consumers.

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.

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.

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 as allowed by the Comptroller's Office are listed in **Exhibit 1.**

Exhibit 1
Long-term Care Insurance Tax Credits

Tax Year	Returns	Amount
2000	2,537	$1,615,645
2001	5,185	3,044,111
2002	8,691	5,061,600
2003	12,756	8,436,163
2004	6,221	4,523,646
Total	**35,390**	**$22,681,165**

The amounts reported above are less than the amount that has been reported in past annual reports issued by the Comptroller's Office. Part of the difference is due to improved data collection and analysis while the other part is due to taxpayers claiming the credit in error. Not included in the totals above is approximately $4.2 million in credits that the Comptroller's Office has determined have been claimed in error. The amount claimed in error, representing 8,400 credits and an 18.6% overclaim rate, has been forwarded to the Comptroller's Compliance Division for adjustment. The Comptroller's Office advises that it has sent out assessments for some of these tax returns and that going forward, any tax return claiming the return will be put into suspense until it can be verified that the credit was claimed accurately.

Most of the credits were claimed on behalf of individuals between 51 and 64 years old. Slightly less than one-quarter were less than 50 years old (including 691 credits for insureds under 21 years old) and slightly less than one-fifth were claimed on behalf of insureds who were 65 years old and older. Approximately 1.5 credits were claimed per tax return at an average of $434. Sixty-three percent of credits were claimed on behalf of the taxpayer, 35% on behalf of the taxpayer's spouse, and the remaining 2% were claimed on behalf of a taxpayer's parent or child.

Exhibit 2 lists the percent of tax returns that claimed the credit by the amount of the taxpayer's Maryland Adjusted Gross Income (MAGI).

Exhibit 2
Tax Returns Claiming the Credit by MAGI
Tax Year 2000-2004

MAGI	Percent of Total Returns
Under $30,000	4%
$30,000-$60,000	14%
$60,000-$100,000	27%
Over $100,000	56%

The Congressional Budget Office estimates that, nationally, a typical premium for a 65-year old cost $2,014 in 2002. Premiums increase with age; a 30-year old could purchase a policy for as little as $284 in 2002.

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.

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.

State Revenues: This bill expands the existing tax credit by allowing individuals to claim the credit for every year the policy is in effect (at a reduced rate beginning in the second year) and not just one time as provided under current law and by allowing individuals who were insured before July 1, 2000 to qualify for the credit. This expansion is effective tax year 2006. As a result, general fund revenues would decrease by an estimated $34.8 million in fiscal 2007 based on the following facts and assumptions:

- In tax year 2000 to 2004, 35,400 returns claimed the credit on a one-time basis. Approximately $22.7 million was claimed in this period and could be claimed on an annual basis beginning in fiscal 2007.
- An estimated 67,200 policies sold before July 1, 2000 are in force and could be claimed at a maximum value of $500 beginning in fiscal 2007 and $100 every year thereafter.
- The average credit claimed per tax policy in 2000 to 2004 was $434.
- The estimated number of policies in force each year is based on the renewal rates of long-term care insurance policies as reported by the Society of Actuaries and America's Health Insurance Plans.
- The amount of policies claiming the credit increases by approximately 5% annually.

The bill provides substantial incentive for younger individuals to buy long-term care insurance by providing a credit for a large portion of the policy's cost. Because of this incentive, revenue losses could be higher than estimated. In addition, these estimates did not include the amount of credits that were claimed in error from tax year 2000 through 2004. It is assumed that the Comptroller's Office will implement an effective compliance measure in order to ensure that only credits that are claimed correctly will be allowed in the future.

Additional Information

Prior Introductions: SB 496 of 2005, a similar bill, was not reported from the Budget and Taxation Committee.

Cross File: None.

Information Source(s): Comptroller's Office, America's Health Insurance Plans, Congressional Budget Office, Society of Actuaries, Department of Legislative Services

Fiscal Note History: First Reader - February 16, 2006
nas/hlb

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