Department of Legislative Services

Maryland General Assembly
2006 Session

FISCAL AND POLICY NOTE

Senate Bill 247 (Senator McFadden)
(By Request – Baltimore City Administration)

Budget and Taxation

Income Tax Subtraction Modification for Seniors' Medical Expenses

This bill creates a subtraction modification under the State income tax for qualified medical expenses incurred by an individual who is at least 65 years old. Subject to limitations, an eligible individual can deduct up to $6,000 in qualified medical expenses.

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 $8.2 million in FY 2007, which reflects estimated amount of eligible deductions and amount claimed under the federal medical deduction. Future years reflect estimated amounts of eligible medical expenses claimed. General fund expenditures could increase by approximately $43,700 in FY 2007, which reflects changes to the State tax booklet.

(in dollars)	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
GF Revenue	($8,204,100)	($8,750,800)	($9,334,200)	($9,956,700)	($10,621,000)
GF Expenditure	43,700	42,700	43,200	43,600	44,000
Net Effect	($8,247,800)	($8,793,500)	($9,377,400)	($10,000,300)	($10,665,000)

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

Local Effect: Local government revenues would decrease by approximately $5.4 million in FY 2007, increasing to $6.9 million in FY 2011. Local government expenditures are not affected.

Small Business Effect: None.

Analysis

Bill Summary: This bill allows an individual to deduct up to $6,000 in qualified medical expenses provided the individual is at least 65 years of age on the last day of the taxable year. The subtraction is reduced by 20% of the amount by which federal adjusted gross income (FAGI) exceeds $25,000. No subtraction is allowed for individuals having FAGI over $55,000. If an individual itemizes deductions for State income tax purposes, the subtraction may not exceed the lesser of 7.5% of the individual's FAGI or $6,000. Qualifying medical expenses paid are those that qualify under the federal medical and dental expenses deduction under Section 213(D) of the Internal Revenue Code. Unreimbursed medical expenses paid on behalf of the individual, spouse, and qualified dependents can qualify for the deduction.

Current Law: No similar State subtraction modification exists, but a taxpayer who claims the federal medical and dental expenses deduction can typically lower State tax liability as discussed below.

Background: The federal medical and dental expenses deduction allows individuals who itemize deductions to deduct expenses paid that year for medical care (including dental). In order to qualify for the deduction, the expenses must total more than 7.5% of the taxpayer's FAGI. The value of the deduction is equal to the amount by which the eligible medical expenses exceed 7.5% of the taxpayer's FAGI. Unreimbursed expenses paid during the year, regardless of when the services were provided, on behalf of the individual, spouse, and qualified dependents qualify for the deduction.

Expenses must be paid for the prevention or alleviation of a physical or mental defect or illness. Eligible expenses include doctor and hospital fees, nursing services, laboratory fees, acupuncture, inpatient drug or alcohol treatment, smoking cessation programs, health insurance premiums, weight-loss programs for specific disease(s) as diagnosed by a physician, and transportation expenses incurred while receiving medical care. In addition, the cost of certain medical equipment such as wheel chairs, crutches, and prescription eyeglasses qualify. Long-term care insurance premiums qualify for a limited deduction.

If a taxpayer who takes the federal medical and dental expenses deduction also itemizes for State income tax purposes (which is usually the case), the deductions taken for federal income tax purposes will flow through to State income tax purposes in that it will reduce the taxpayer's Maryland taxable income. The value to a taxpayer of a State deduction, however, is less than a federal deduction since State income tax rates are lower (the highest State tax rate is 4.75%, compared with a top federal rate of 35%).

In tax year 2003, 8.7 million federal taxpayers nationwide deducted $56 billion in qualified medical expenses. The federal Joint Committee on Taxation estimates that the deduction will reduce federal income tax revenues by approximately $8.2 billion in fiscal 2006. Legislative Services estimates that the federal deduction reduced State income tax revenues by approximately $64 million in tax year 2003.

State Revenues: Subtraction modifications could be claimed beginning in tax year 2006. As a result, general fund revenues could decrease by approximately $8.2 million in fiscal 2007. This estimate is based on the following facts and assumptions.

- There were 121,798 tax returns in 2004 that meet the age and income eligibility requirements of the bill.
- The estimated amount of eligible health care expenditures claimed is based on the amounts reported in the 2003 Consumer Expenditure Survey.
- Taxpayers who were 65 years of age and older, had FAGI under $55,000, and itemized claimed a total of approximately $131.9 million under the federal medical and dental expenses deduction in tax year 2004.
- The amount claimed under the federal deduction has increased by approximately 8% annually from 1990 to 2003.
- The average amount of medical expenses claimed by individuals who do not itemize increases by approximately 4% annually.
- According to the U.S. Census Bureau, the number of individuals aged 65 years and older is projected to increase by approximately 2.3% annually from 2005 and 2010.

State Expenditures: The Comptroller's Office reports that it would incur a one-time expenditure increase of $1,370 to add the subtraction modification limitations and phase-out information to the tax booklet and an annual increase of $42,300 due to additional printing expenses.

Local Revenues: Local government revenues would decrease by approximately 3% of the total State subtraction modifications taken in each tax year. In fiscal 2007, the decrease would total approximately $5.4 million. Future year revenues would decrease by approximately $5.7 million in fiscal 2008, $6.1 million in fiscal 2009, $6.5 million in fiscal 2010, and $6.9 million in fiscal 2011.

Additional Information

Prior Introductions: None.

Cross File: HB 439 (Delegate Marriott, *et al.*) (By Request – Baltimore City Administration) – Ways and Means.

Information Source(s): Comptroller's Office, Department of Legislative Services

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