

Department of Legislative Services
2010 Session

FISCAL AND POLICY NOTE

Senate Bill 1003

(Senator Pugh)

Budget and Taxation

**Income Tax - Subtraction Modification - Health Improvement and Disease
Prevention Act of 2010**

This bill creates a subtraction modification against the State income tax for qualified expenses related to fitness activities, tobacco cessation, and weight loss programs. The amount of the subtraction modification cannot exceed \$1,500 (\$750 for married couples filing separately). The Comptroller, in cooperation with the Department of Health and Mental Hygiene (DHMH), must administer the subtraction modification and adopt regulations that specify expenses eligible for the subtraction modification. The Comptroller and DHMH must report to the General Assembly by September 1, 2010, on the implementation of the bill.

The bill takes effect July 1, 2010, and applies to tax year 2011 and beyond.

Fiscal Summary

State Effect: General fund revenues will decrease significantly beginning in FY 2012 due to subtraction modifications claimed against the personal income tax. If 10% of taxpayers claim the maximum subtraction modification, State revenues will decrease by \$15.7 million. Revenues losses could be significantly more. General fund expenditures increase by \$21,300 in FY 2011 for one-time tax form changes and computer programming modifications at the Comptroller's Office.

Local Effect: Local revenues will decrease significantly beginning in FY 2012. Assuming that 10% of taxpayers claim the maximum subtraction modification, local revenues will decrease by \$9.8 million. Expenditures are not affected.

Small Business Effect: Minimal.

Analysis

Bill Summary: The bill creates a subtraction modification against the State income tax for specified wellness-related expenses. Expenses that qualify include (1) qualified fitness expenses for the taxpayer, taxpayer's spouse, or adult dependent; (2) participation by the taxpayer, taxpayer's spouse, or dependent in a qualified tobacco cessation program or weight loss program; or (3) participation by a dependent child in a qualified physical activity program. The Comptroller, in cooperation with DHMH, must administer the subtraction modification and adopt regulations that specify expenses eligible for the subtraction modification.

The amount of the subtraction may not exceed \$500 of qualifying expenses occurred for each taxpayer, spouse, or dependent for whom the benefit is claimed. This limit is increased to \$750 if the qualified individual is over 65 years old. The total value of the subtraction modification may not exceed \$1,500 (\$750 for a married individual filing a separate return).

Current Law: Certain medical-related expenses discussed below can be deducted for federal income tax purposes which typically results in a lower federal and State income tax liability.

Background: Medical expenses under the Internal Revenue Code are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body. They include costs of equipment, supplies, and diagnostic devices needed for these purposes. Medical expenses must be primarily to alleviate or prevent a physical or mental illness or defect. Expenses that are beneficial to general health, such as vitamins or a vacation, do not qualify. Qualifying medical expenses may be deducted if an individual itemizes and is equal to the medical expenses in excess of 7.5% of federal adjusted gross income. The cost of tobacco cessation programs qualify for the deduction as well as the cost of weight-loss programs if it is a treatment for a specific disease diagnosed by a physician. In addition to the medical expenses deduction, individuals may opt to pay for certain medical expenses out of a health savings account and other tax-favored health plans.

According to the Centers for Disease Control and Prevention chronic diseases – such as heart disease, stroke, cancer, diabetes, and arthritis – are among the most common, costly, and preventable of all health problems in the United States. Four modifiable health risk behaviors – lack of physical activity, poor nutrition, tobacco use, and excessive alcohol consumption – are responsible for much of the illness, suffering, and early death related to chronic diseases. Research has identified the benefits of preventative care and behavior modification in reducing chronic disease incidence. Some

employers and health care companies have instituted programs providing for the payment or reimbursement of costs associated with employee/member participation in healthy behavior and wellness programs. The U.S. Congress has considered legislation offering tax credits to businesses that offer wellness programs and/or designed to reduce perceived federal law barriers to companies implementing effective wellness programs.

State Revenues: Subtraction modifications may be claimed beginning in tax year 2011. Accordingly, general fund revenues will decrease significantly beginning in fiscal 2012. However, the amount of the revenue loss cannot be reliably estimated and depends on the type of expenses that qualify for the subtraction modification and the amount of individuals claiming the benefit. The Consumer Expenditure Survey provides information on consumer expenditures by class of expenditure but does not include enough detail to estimate the expenditures that will qualify under the bill. **Exhibit 1** shows the decrease in State and local revenues if a certain percentage of taxpayers claim the maximum subtraction modification.

Exhibit 1
Potential State and Local Revenue Decrease
(\$ in millions)

<u>Percent of Taxpayers</u>	<u>State</u>	<u>Local</u>	<u>Total</u>
5%	\$7.8	\$4.9	\$12.7
10%	15.7	9.8	25.5
25%	39.1	24.5	63.6

State Expenditures: The Comptroller’s Office reports that it will incur a one-time expenditure increase of \$21,300 in fiscal 2011 to add the subtraction modification to the personal income tax return. This includes data processing changes to the SMART income tax return processing and imaging systems and system testing.

Local Revenues: Local income tax revenues may decrease by about 3% of the total subtraction modification claimed. Exhibit 1 illustrates the loss of local revenues depending on how many individuals claim the maximum subtraction modification.

Additional Information

Prior Introductions: HB 711 of 2009 was not reported from the House Ways and Means Committee.

Cross File: HB 1105 (Delegate Cardin, *et al.*) - Ways and Means.

Information Source(s): Centers for Disease Control and Prevention, Comptroller's Office, Department of Legislative Services

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