SB 23

Department of Legislative Services
2013 Session

FISCAL AND POLICY NOTE

Senate Bill 23 (Senator Klausmeier, *et al.*)
Budget and Taxation

Income Tax - Credit for Long-Term Care Premiums

This bill alters the existing one-time long-term care insurance income tax credit of $500 by allowing a maximum credit of $200 to be claimed for every year a policy is in force. The credit is applicable to policies issued after December 31, 2013.

The bill takes effect July 1, 2013, and applies to tax year 2014 and beyond.

Fiscal Summary

State Effect: General fund revenues increase by $1.7 million in FY 2015 and by $0.2 million in FY 2016, which reflects a net decrease in the amount of credits claimed as a result of decreasing the value of the credit in the first tax year. General fund revenues decrease beginning in FY 2017 as revenue losses from allowing the credit to be claimed in successive years continue to increase and are greater than the revenue gains resulting from reducing the value of the credit in the first year. Expenditures are not affected.

($ in millions)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
GF Revenue	$0	$1.7	$0.2	($1.3)	($2.8)
Expenditure	0	0	0	0	0
Net Effect	$.0	$1.7	$0.2	($1.3)	($2.8)

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 (SB 171) allows 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 for any individual's long-term care insurance policy in any prior taxable year. 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 (IRC). The maximum premium amounts under federal guidelines for tax year 2013, based on the age of the insured, are $360 for age 40 or younger, $680 for ages 41 to 50, $1,360 for ages 51 to 60, $3,640 for ages 61 to 70, and $4,550 for ages 71 and over. These amounts are indexed according to the annual increase in the medical component of the Consumer Price Index for all urban consumers.

In addition to the State income tax credit, 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. The deduction is subject to the annual limitations described in Section 213 (d)(10) of the IRC.

In addition, Chapter 7 of 1998 (SB 638) 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 insurance premium tax, or individual and corporate income taxes.

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 the elderly, the functionally and developmentally disabled, and individuals suffering from mental disorders such as dementia and Alzheimer's.

Due to the aging of the population, long-term care utilization is expected to increase significantly in the near future. The Kaiser Commission on Medicaid and the Uninsured estimated that of the $169 billion in long-term care spending in 2005; a little less than three-quarters was for nursing home expenditures. A recent University of Pennsylvania study noted that the heavy burden on governments to finance long-term care has prompted proposals to make long-term care more affordable through tax incentives. The study concluded that the effectiveness of these proposals in stimulating long-term care insurance depended on the availability of Medicaid and the price elasticity of the insurance. The study concluded that subsidies had a modest impact on increasing the total number of policies purchased; reducing the cost of insurance by one-half was estimated to increase the number of long-term care insurance policies by less than 5%.

Chapter 242 of 2000 (SB 171) established a one-time $500 tax credit for the purchase of new long-term care insurance policies in an attempt to promote purchases of these policies. The number of returns claiming the credit and the number and amount of credits claimed are listed in **Exhibit 1**.

Exhibit 1
Long-term Care Insurance Tax Credits
2000-2011

Tax Year	Returns	Credits	Amount Claimed ($ in Millions)	Average Credit Claimed
2000	2,537	3,658	$1.6	$442
2001	5,185	7,032	3.0	433
2002	8,691	12,367	5.1	409
2003	12,756	18,964	8.4	445
2004	6,221	10,238	4.5	442
2005	8,470	11,751	5.3	447
2006	6,192	8,210	3.6	440
2007	6,089	7,778	3.3	431
2008	5,172	6,735	2.9	426
2009	5,081	6,527	2.7	421
2010	5,098	6,546	2.8	428
2011	5,729	7,527	3.3	437
Total	**77,221**	**107,333**	**$46.5**	**$433**

Not included in Exhibit 1 is approximately $4.2 million in credits that the Comptroller's Office determined were claimed in error through tax year 2004, representing 8,400 credits, and an 18.6% overclaim rate. In 2004, the Comptroller's Office determined that the credit had been claimed more than once for any given insured individual by many taxpayers. Procedures were put in place in 2005 to prevent that from occurring again, including an expansion of the data collected from these returns.

In addition to reporting data on the amount of credits claimed in each year, Chapter 242 (SB 171) also required the Comptroller's Office to report the savings under the State medical assistance program as a result of additional individuals being covered by long-term insurance as a result of the credit. The report states that although the additional number of individuals who are covered by insurance as a result of the credit is unknown, little if any savings to the State are likely at this point.

State Revenues: The bill alters the existing tax credit beginning in tax year 2014 by allowing individuals to claim a maximum credit of $200 for every year the policy is in effect and not just $500 in the first tax year as provided under current law. This is applicable to individuals who were not covered by long-term care insurance at any time before January 1, 2014. As a result, general fund revenues will increase by an estimated $1.7 million in fiscal 2015 and by $221,000 in fiscal 2016. State revenues will decrease beginning in fiscal 2017 as revenue losses from allowing the credit to be claimed in each year the policy is in effect are greater than revenue gains resulting from the decrease in the value of the credit in the first year. This estimate is based on the following facts and assumptions:

- It is estimated that, under current law, a total of $3.3 million in credits will be claimed annually beginning in tax year 2014.
- An average credit of $437 was claimed in tax year 2011 – it is assumed that the maximum credit proposed by the bill will be claimed in each year.
- The price elasticity of long-term insurance policies is estimated to be -0.1.
- The estimated number of policies in force in successive years is based on the renewal rates of long-term care insurance policies as reported by the Society of Actuaries.

Additional Information

Prior Introductions: SB 35 of 2012 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. Its cross file, HB 347, received a hearing in the House Ways and Means Committee, but no further action was taken. Similar bills were introduced in the 2010 and 2011 sessions. SB 618 and SB 703 of 2011 received a hearing in the Senate Budget and Taxation Committee, but no further action was taken. HB 562 of 2011 and HB 382 of 2010 received a hearing in the House Ways and Means Committee, but no further action was taken. The cross file of HB 382, SB 460, received a hearing in the Senate Budget and Taxation Committee, but no further action was taken.

Cross File: None.

Information Source(s): Comptroller's Office, Internal Revenue Service, Kaiser Commission on Medicaid and the Uninsured, Society of Actuaries, University of Pennsylvania, Department of Legislative Services

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