House Legislative Analysis Section

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LONG-TERM CARE INSURANCE: INCOME TAX DEDUCTION

House Bill 4292 (Substitute H-1)
First Analysis (10-21-03)

Sponsor: Rep. Chris Ward
Committee: Tax Policy

THE APPARENT PROBLEM:

In a June 2000 report entitled Long Term Care Innovations: Challenges and Solutions, the Michigan Long Term Care Work Group (under the aegis of the Department of Community Health) said:

"Significant increases in life expectancy, a growing elderly population, and advances in medical technology are setting the stage for long term care (LTC) challenges in the 21st century for Michigan and the rest of the nation. It is imperative that Michigan plan for the future of long term care in order to meet the needs of future generations who will depend upon public resources for some or all of their care.

In the next few decades the number of adults with disabilities and the elderly population will dramatically grow, as the nation's 77 million baby boomers move into their senior years. Here in Michigan, the fastest-growing component of persons who may need Medicaid for their long term care support is the non-elderly disabled. These are people who are living longer lives due advances in medical technology but who require support services to cope with chronic health conditions and functional limitations. Much of the financial responsibility to provide these services will fall to state government and future taxpayers."

The report goes on to say that, "Without changes, Medicaid will be unable to support future long-term care needs without severely limiting the state's ability to fund other necessary programs. Medicaid is now [in 2000] 20 percent of Michigan's total budget. Without action now, the future cost of Medicaid will grow rapidly, primarily because it is the only source of public funding for long-term care for low-income individual and families."

According to information from the National Governors Association, the primary payers of long-term care are Medicaid (40 percent), out-of-pocket spending (26 percent), Medicare payments for skilled nursing (20 percent), private insurance (8 percent), and other sources (6 percent). The NGA says nursing home care costs on average about $56,000 per year and assisted living costs about $26,300 per year.

One (among many) of the ways of addressing this growing problem cited by the work group's report is the increased private purchase of long-term care insurance. While conceding that not everyone can afford this option, the report cites a 1994 study claiming that "for every 1 million long term care policy holders that enter nursing homes, Medicaid stands to save $3.5 billion to $6.9 billion over the next 25 years." The report makes a number of recommendations for changes in state policy in order to encourage more people to purchase this product (including changes in the design and marketing of the product itself).

One approach that some people advocate as a means of promoting the purchase of long-term care polices is preferential tax treatment; specifically, permitting the cost of premiums to be deducted from taxpayer income for state income tax purposes. Legislation to accomplish this has been introduced.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act to allow taxpayers to deduct from taxable income premiums paid in the tax year to obtain long-term care benefits. The deduction would apply for tax years beginning after December 31, 2004, and would apply to the extent the premiums had not already been deducted in determining adjusted gross income.

MCL 206.30

BACKGROUND INFORMATION:

Tax Preferences: In written testimony provided to the Committee on Tax Policy, the American Council of Life Insurers (ACLI) notes that 21 other states

have adopted some sort of tax incentive for the purchase of long-term care insurance. These tax incentives include deductions (which reduce a taxpayer's taxable income) and credits (which directly reduce a taxpayer's tax liability). Ohio offers a deduction in a manner substantially the same as this bill (see Ohio Revised Code 5747.01). Minnesota provides for a tax credit equal to 25 percent of the premiums paid to the extent not deducted in determining federal taxable income, though the credit is limited to $200 for a married couple filing jointly and $100 for all other filers (see Minnesota Statutes, 290.0672). Oregon provides a credit against the personal income tax for the amount paid or incurred for long-term care insurance by an individual on behalf of him/herself, dependents or parents, and it provides a credit against the corporate income tax for amounts paid or incurred by an employer on behalf of its employees who are state residents. The credit is limited to 15 percent of the premium paid or $500, whichever is less.

Consumer Reports Article. The most recent edition of the magazine Consumer Reports (November 2003) contains an article entitled, "Do You Need Long-Term-Care Insurance?" It is fair to say that the article portrays the product in a negative light, but nevertheless provides advice to consumers contemplating such a purchase. The article notes, "Long-term-care insurance is a costly form of disability insurance, and you may not use it for 20, 30, or more years if at all. Your first step should be to decide if your circumstances warrant taking on the risk and expense of long-term-care insurance." Of the 47 policies it examines, CR recommends 3 for purchase, and recommends that people consider purchasing LTC insurance beginning at age 60. The article also says that 1 percent of people ages 65 to 74 live in a nursing home; 4 percent of 75- to 84-year olds; and 19 percent of those 85 and older. The article can be found on the magazine's web site at www.consumers.org

Premium Costs. Although estimates of prices of long-term care insurance vary (and depend upon the features of the policies), the National Governors Association estimates that in 2001, a policy with common features purchased at age 50 cost $1,022; at age 65, $2,261; and at age 79, $7,002. These are annual premiums.

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the bill would reduce income tax revenue by an estimated $21 million in tax year 2005. About 77 percent of this reduction would affect the General Fund and 23 percent would affect the School Aid Fund. The agency notes that to the extent tax benefits are taken through refunds, the affect on the General Fund would be greater and the affect on the School Aid Fund less. (HFA analysis dated 10-17-03)

ARGUMENTS:

For:

In written testimony provided to the Committee on Tax Policy, the American Council of Life Insurers notes, "Michigan is about to be hit by unprecedented growth in its elderly population. With baby boomers approaching their retirement years, the number of Michigan residents over age 65 is expected to increase substantially. Not only will there be more elderly, but they will be living longer than any generation before them. As a result, Michigan's population aged 84 and older will increase dramatically. Individuals in this group are most like to have chronic health problems or disabilities that require long-term care. Unless baby boomers are encouraged to plan for their long-term care needs, rising demand for these services will place an extraordinary burden on already strained government programs."

In addition, the ACLI notes that approximately 77 percent of working-age adults (ages 35 to 64) in Michigan can afford to purchase long-term care; approximately 29 percent of older state residents can afford to purchase long-term care insurance; and if Michigan residents who could afford long-term care insurance purchased a policy, state Medicaid expenditures could be reduced over 20 percent by 2030, based on national trends.

The bill, then, is seen as one step at encouraging individuals to purchase long-term care insurance, thereby helping to reduce the state's future Medicaid expenditures.

Response:

Critics say that it is not clear the bill will have the desired affect on state Medicaid expenditures. Any impact on Medicaid would be in the distant future (from individuals purchasing policies now). Medicaid, moreover, is funded less than half by state government. Further, since people purchase these policies in part to protect private assets (which would otherwise themselves have offset Medicaid costs), some portion of the credit – perhaps half -- can be said to be going toward that purpose. And, some portion of the premiums that policyholders pay go not toward the payment of claims but toward

company profits and agent commissions. A Department of Treasury official has also said that consumption is not likely to increase with a four percent reduction in price, estimating that $10 in foregone state revenue would be likely to result in at best $1 in future state savings.

Against:
Deducting the cost of premiums from taxable income means that the taxpayer will, essentially, reduce the cost of the premiums by roughly four percent (the income tax rate). For instance, if the premiums are $2,000, the reduction in taxes only amounts to $80. There is no doubt that this will be beneficial to individuals who are currently purchasing their own long-term care insurance. But it is questionable whether the tax break is sufficient to make long-term care insurance affordable for people who cannot now afford it and who, in all likelihood, would be the people who in the future would rely heavily on Medicaid to finance their long-term care. It is also questionable whether individuals who can afford to purchase a long-term care policy, but who for whatever reason don't, will find the relatively small tax benefit sufficient reason to change their minds.

Against:
However noble the bill's intentions, given the fiscal realities facing the state at this time, it is simply not prudent to further reduce state tax revenue. This bill could reduce state revenues by an amount in the vicinity of $20 million annually, according to some estimates. The tax deduction offered here, like other tax preferences, further erodes the state income tax base. Some people believe the better approach would be to lower the overall tax rate and reduce the number of tax preferences that have been enacted to encourage or reward taxpayer behavior.

Response:
The bill represents a worthy state policy goal. Special tax treatment can be one component in a larger educational and promotional effort to encourage individuals to purchase long-term care insurance. (People are unlikely to respond to a direct appeal to help reduce Medicaid costs.) As the recent report by the long-term care work group noted, "Long term care is one way individuals can protect themselves from the cost of care. [It] provides its owners with more choices and controls. It also preserves private resources. Most people mistakenly believe that they have coverage for long term care either through either Medicaid or regular health insurance [and] don't realize the high risk of remaining uninsured. There is about a 1.3 percent probability that an average person will ever use their homeowners insurance and about a 2.5 percent probability they will use their automobile insurance. In contrast there is a 43 percent probability that a person will receive nursing home services after 65 and a significantly greater probability that they will receive some form of long term care support."

POSITIONS:

The Department of Treasury opposes the bill. (10-15-03)

The Michigan Chamber of Commerce indicated that its supports the bill. (10-1-03)

The American Council of Life Insurers indicated that its supports the bill. (10-1-03)

The Life Insurance Association of Michigan indicated that its supports the bill. (10-1-03)

The Detroit Regional Chamber indicated that its supports the bill. (10-1-03)

The Michigan Country Medical Care Facilities indicated that it supports the bill. (10-15-03)

The Michigan Association of Insurance Agents indicated that it supports the bill. (10-1-03)

The American Association of Retired Persons (AARP) indicated that it supports the bill. (10-1-03)

The Michigan Association of Homes and Services to the Aging indicated that it supports the bill. (10-15-03)

Prudential Financial indicated that it supports the bill. (10-15-03)

The Health Care Association of Michigan indicated in written testimony that it supports the bill. (9-30-03)

Analyst: M. Wolf

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.