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GREAT SEAL STATE OF NORTH DAKOTA 1889

ROLL NUMBER

DESCRIPTION

1215

2005 HOUSE FINANCE AND TAXATION

HB 1215

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1215**

House Finance and Taxation Committee

☐ Conference Committee

Hearing Date **January 18, 2005**

Tape Number	Side A	Side B	Meter #
1	**x**		**20**

Committee Clerk Signature Janice Stein

Minutes:

REP. TODD PORTER, DIST. 34, MANDAN Introduced the bill. This bill relates to a current tax credit which is present on our long form, and moving it over to our so-called, short form Our short form has gone from a post card to a two page, 8 ½ x 11 piece of paper. We are also thinking of eliminating the long form.

I looked at this last session, I think it had a four million dollar fiscal note last session, I am encouraged of the fact that it has a six million dollar fiscal note this session. This means people are actually out buying long term care insurance. In the long run, for the state of North Dakota, it is a good investment. It is sometimes difficult looking at our budgets in two years. We have to take a look at what it will take to encourage people to buy long term care insurance. The one hundred and twenty five dollar credit people would get on the short form, is a small pittance to what the premium cost per year is. Currently, business owners, farmers that are incorporated, are already allowed to deduct those premiums, under their business. Small business owners can already deduct it as an expense. Individuals who can't, are the individuals who are out working their jobs and doing their estate planning and long term planning for retirement, they want to protect their assets, they are the ones who cannot use this type of insurance as a deduction. We as a legislature have to make a move and look further than two years away, when the population of the baby boomers are at the age where they could end up in a nursing home. Who will pay for it. I don't think we want to burden the general fund of the state of North Dakota.

REP. DROVDAL There is a bill in eliminating ND-2, we had testimony on that yesterday, one of the things we found, that there is several of these deductions we need to move over to ND-1, and we will need a vehicle to do that, what is your thought about adding several other options onto your bill?

REP. PORTER I would hate to pile too much on top of this, but if it is the only vehicle you have to get the job accomplished, not knowing, there are numerous items on there that should be deducted. We have to look past a two year fiscal effect.

JIM POOLMAN, NORTH DAKOTA INSURANCE COMMISSIONER Testified in support of the bill. Much of the information being quoted, comes from our department. This is not a new issue. It is a little different though because the tax department introduced the elimination of ND-2. We have done a lot of regulation of long term care policies over the past couple years, to try to put some price stability in long term care. The long term policies evolved enormously over the past ten years. The long term policies are providing much different services as they have before, from assisted living benefits, to home health care benefits, which I think keep people out of long term care facilities, much longer than they used to.

The general fund does collect from long term care policies in the premium packs. The long term care policies are adding dollars to the general fund at about two percent on earned premium. That is an important fact to consider. When looking at all of these particular credits and incentives, I think you need to weigh the incentive versus the benefit. One of the things we have struggled very hard with, is to actually quantify what the state general fund would get back in the long term versus the short term payout, to incentify, people to buy long term care insurance. There is a tangible benefit to keep people off of medicaid in the long run. See additional information Mr. Poolman submitted to the committee members.

REP. BELTER Do you have any information on what income class is buying the long term care.

JIM POOLMAN We would not have any specific information as to the profile of the purchasers of long term care. I do know there are people actually working with consumers every day, that will be able to give you some very good information about it.

REP. BELTER That would be very good, important information, because if the bulk of the people are the most likely to become the people eligible for medicaid.

RICK CLAYBURGH, STATE TAX COMMISSIONER Testified in support of the bill. The way this bill is written and drafted, it does provide the caps which currently occur with the long form. The fiscal note is approximately 5.5 million dollars based on the current cap an individual can receive, it is a credit of up to twenty five percent of the premium, capped at one hundred dollars per insured individual. Potentially, on a tax return, it could be a married, filing joint, up to two hundred dollars. From the standpoint of the tax department, we can administer this, it is not a concern or burden. You could use HB 1155 as a vehicle and wouldn't have to muddy up Rep. Porter's bill at all.

PAMELA SCHMIDT, VICE PRESIDENT OF SCHMIDT INSURANCE SERVICES & SIA MARKETING Testified in support of the bill. See attached written testimony.

REP. KELSH I am happy to hear that you have been successful in your marketing efforts and getting to younger people, getting them to buy insurance, doesn't that also mean it has been working without a credit, the fiscal note shows people have been buying long term care insurance without having a credit.

PAMELA SCHMIDT Yes, you can make the argument that it has been working well, but I can tell you that as an industry, we had a thirty five percent increase, but there is a lot more we can be doing.

SHELLY PETERSON, PRESIDENT OF THE NORTH DAKOTA LONG TERM CARE ASSOCIATION, Testified in support of the bill. See attached written testimony.

DAVID ZENTNER, DIRECTOR OF MEDICAL SERVICES FOR THE DEPARTMENT OF HUMAN SERVICES. Testified in support of the bill. See attached written testimony.

REP. CONRAD Will we recoup what we lost going from the long form to the short form?

DAVID ZENTNER Immediately, no, you have to be in it for the long run, if you have people in their fifty's buying insurance, they are likely not going to use it until they are in their seventies and eighties. If you are going to look at this bill, you cannot look at it in the short term, there will not be an immediate return on six million dollars.

REP. CONRAD How long will it take to recoup six million this biennium and six million next biennium?

DAVID ZENTNER I can't give you a set time frame on that. What I do know is that if you look what is happening on the medicaid side, with long term care, if you look down the road ten or twelve years, rather then three hundred and fifty million, you will be looking at seven hundred million. That is the trade-off. When we would recoup those dollars, is hard to say.

REP. BELTER You have the figure of 56% nursing home residents are on medicaid, how many people is that?

DAVID ZENTNER It is about 3500 - 3600 in any month.

NORBERT MAYER ON BEHALF OF THE NORTH DAKOTA ASSOCIATION OF INSURANCE & FINANCIAL ADVISORS Testified in support of the bill. See attached written testimony.

REP. DROVDAL Are there plans out there that an individual can purchase whereas, if he doesn't use them, they work more like an investment, if he doesn't use them, he can recover some of his money back?

NORBERT MAYER there are some of those plans out there. They have been available as a rider on a life insurance contract, the only problem is with the return of premium, the initial premium has to be extremely large, because now all of a sudden, you are relying only on those people that used those plans to pay for those particular costs.

REP. DROVDAL Would that money be taxed?

NORBERT MAYER No, I do not believe there is a way to tax that.

REP. CONRAD How many people are in long term care facilities using the insurance?

Someone from the sidelines stated, it is fifteen percent in assisted living and thirteen percent in home health care is collected from private insurance.

REP. KELSH My wife and I just bought long term care insurance a couple years ago, we didn't do it because we got the credit, because we don't use the long form, we did it because we had a hearing on this issue four years ago, and it came to light that it was a good idea to do this. I am wondering instead of the state taking a six million dollar hit for a tax credit, wouldn't it be better to invest a million dollars in a healthy ad campaign to get people to buy long term insurance?

NORBERT MAYER I guess we need whatever it takes to get people to purchase. People are all driven by greed, and people would like to keep their money and still not have to pay for that long term care. This kind of goes to that greed portion, which says, we get something back directly if we purchase the long term care insurance.

With no further testimony, the committee hearing was closed.

2005 HOUSE STANDING COMMITTEE MINUTES

BILL/RESOLUTION NO. **HB 1215**

House Finance and Taxation Committee

❑ Conference Committee

Hearing Date **February 7, 2005**

Tape Number	Side A	Side B	Meter #
1	**X**		**9.8**

Committee Clerk Signature

Minutes:

COMMITTEE ACTION

REP. BRANDENBURG Made a motion for a **do not pass**

REP. IVERSON Second the motion. **MOTION CARRIED.**

13 YES 0 NO 1 ABSENT

REP. IVERSON Was given the floor assignment.

FISCAL NOTE

Requested by Legislative Council
01/07/2005

Bill/Resolution No.: HB 1215

1A. **State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2003-2005 Biennium		2005-2007 Biennium		2007-2009 Biennium	
	General Fund	**Other Funds**	**General Fund**	**Other Funds**	**General Fund**	**Other Funds**
Revenues			($5,560,000)			
Expenditures						
Appropriations						

1B. **County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

2003-2005 Biennium			2005-2007 Biennium			2007-2009 Biennium		
Counties	**Cities**	**School Districts**	**Counties**	**Cities**	**School Districts**	**Counties**	**Cities**	**School Districts**

2. **Narrative:** *Identify the aspects of the measure which cause fiscal impact and include any comments relevant to your analysis.*

HB 1215 enables the individual income tax credit for long-term care insurance premiums to be claimed on the state's standard individual income tax form, Form ND-1. Current law allows this credit only on the optional form (formerly "long-form"), Form ND-2.

3. **State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*
   A. **Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

Based on statistics from the Insurance Department, it is estimated that approx. 29,000 individuals are covered by long-term care insurance. Allowing a Form ND-1 tax credit of up to $100 for each individual covered by a policy is expected to decrease state general fund revenues by $5,560,000 in the 2005-07 biennium.

   B. **Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

   C. **Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, of the effect on the biennial appropriation for each agency and fund affected and any amounts included in the executive budget. Indicate the relationship between the amounts shown for expenditures and appropriations.*

Name:	Kathryn L. Strombeck	**Agency:**	Office of Tax Commissioner
Phone Number:	328-3402	**Date Prepared:**	01/17/2005

Date: 2-7-05
Roll Call Vote #: 1

2005 HOUSE STANDING COMMITTEE ROLL CALL VOTES
BILL/RESOLUTION NO. HB 1215

House **FINANCE & TAXATION** Committee

☐ Check here for Conference Committee

Legislative Council Amendment Number

Action Taken Do Not Pass

Motion Made By Rep. Brandenburg Seconded By Rep. Iverson

Representatives	Yes	No	Representatives	Yes	No
BELTER, WES, CHAIRMAN	✓				
DROVDAL, DAVID, V-CHAIR	✓				
BRANDENBURG, MICHAEL	✓				
CONRAD, KARI	✓				
FROELICH, ROD	✓				
GRANDE, BETTE	✓				
HEADLAND, CRAIG	✓				
IVERSON, RONALD	✓				
KELSH, SCOT	✓				
NICHOLAS, EUGENE	✓				
OWENS, MARK	✓				
SCHMIDT, ARLO	✓				
WEILER, DAVE	A				
WRANGHAM, DWIGHT	✓				

Total (Yes) 13 No 0

Absent 1

Floor Assignment Rep. Iverson

If the vote is on an amendment, briefly indicate intent:

REPORT OF STANDING COMMITTEE

HB 1215: Finance and Taxation Committee (Rep. Belter, Chairman) recommends **DO NOT PASS** (13 YEAS, 0 NAYS, 1 ABSENT AND NOT VOTING). HB 1215 was placed on the Eleventh order on the calendar.

2005 TESTIMONY

HB 1215

Testimony
Before the House Finance and Taxation Committee
January 18, 2005

Mr Chairman, and members of the House Finance and Taxation committee, my name is Pamela Schmidt and I am Vice President of Schmidt Insurance Services and SIA Marketing, two North Dakota-based companies that have specialized in long-term care insurance for 25 years. I come to you today in support of HB1215, with good news to report.

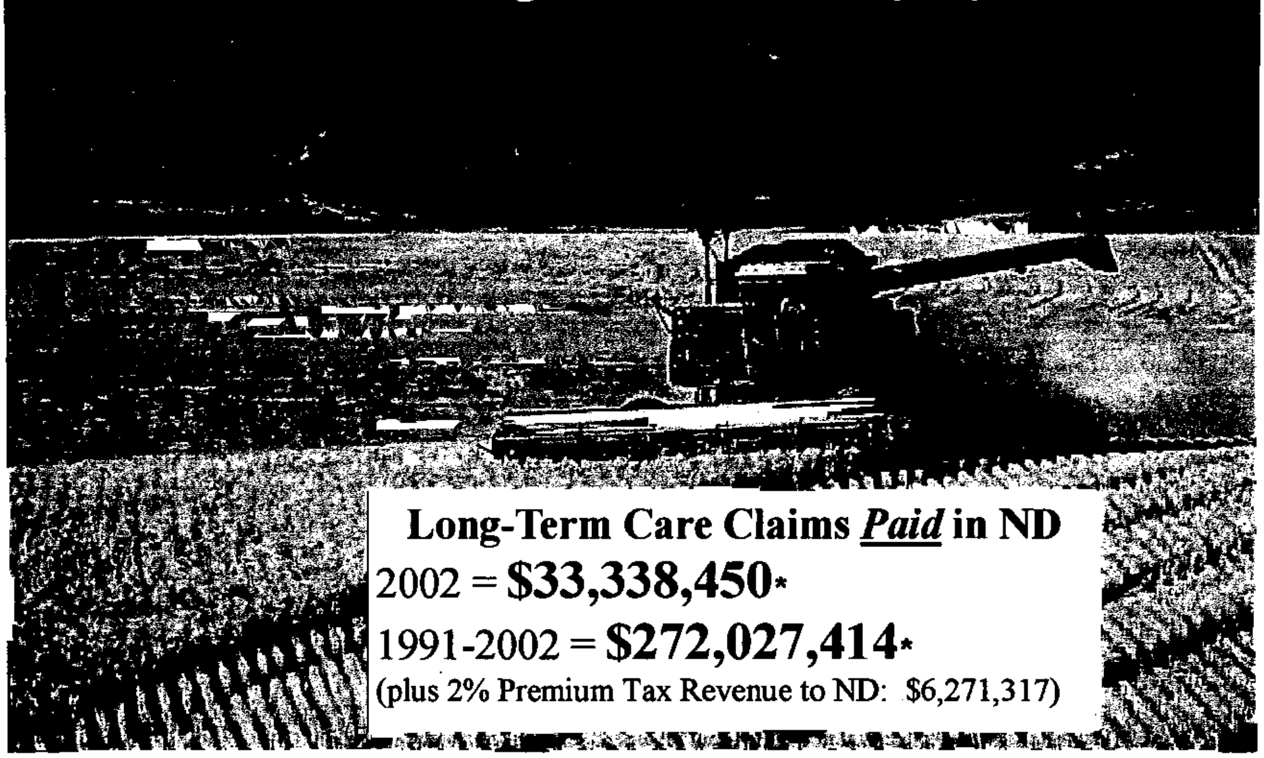
In a nation with skyrocketing healthcare costs and rapidly increasing Medicaid budgets, North Dakota—for the first time in our history and quite possibly the nation's history—is budgeting for *fewer individuals on Medicaid in the nursing home for the next biennium*. Long-term care insurance began planting the seeds for this achievement years ago...I refer you to the attached page for a summary of long-term care insurance **paid claims to North Dakotans**: in 2002, **$33,338,450**...and a grand total of **$272,027,414** in the 11 year period of beginning in 1991 when claim reporting first became a requirement. Those numbers represent **a 77% return** on premium investment and far exceed the numbers reported by our neighboring states.

Long-term care insurance is a huge success in North Dakota...our people, our agents, our insurance department and our providers are all helping to bring these dollars into the state. It's all working beautifully. I hope this harvest lasts for a long, long time.

We currently have a $100 tax credit for North Dakotans with long-term care insurance who file long form. Passage of HB 1215 transfers the tax credit to the short form, encouraging more and possibly younger North Dakotans to purchase long-term care insurance when it is most affordable. It's a small incentive that's goes a long way. I strongly urge you to pass HB 1215 and will be happy to take your questions.

Pam Schmidt

The good news? We're all doing something right... and harvesting more benefits every day.



Long-Term Care Claims *Paid* in ND

2002 = **$33,338,450***

1991-2002 = **$272,027,414***

(plus 2% Premium Tax Revenue to ND: $6,271,317)

	Insured Lives	2002 Paid Claims	1991-2002 Paid Claims	Actual Incurred Claims vs Actual Earned Premiums
North Dakota	**29,069**	**$33,338,450**	**$272,027,414**	**77%** **($313,565,882)**
Minnesota	111,620	$39,632,667	$214,780,272	30% ($669,575,551)
South Dakota	28,332	$22,391,997	$121,191,658	47% ($242,632,379)
Montana	16,728	$12,560,557	$59,021,273	42% (135,963,765

Data obtained from 2003 Long-Term Care Insurance Experience Reports for 2002
National Association of Insurance Commissioners

Why do our numbers compare so well to neighboring states?

- North Dakotans expect to get what they pay for...family members work closely with their home-town agents at claim time.
- ND Agents are well trained...the better trained the agent, the more educated their clients.
- We've sold more LTC insurance per capita, for a longer period of time than most
- Our Insurance Department has done a great job approving high-quality policies.
- Our nursing home, home health care and assisted living providers are tireless in their efforts to file all the paperwork necessary to access every possible benefit from each policy.

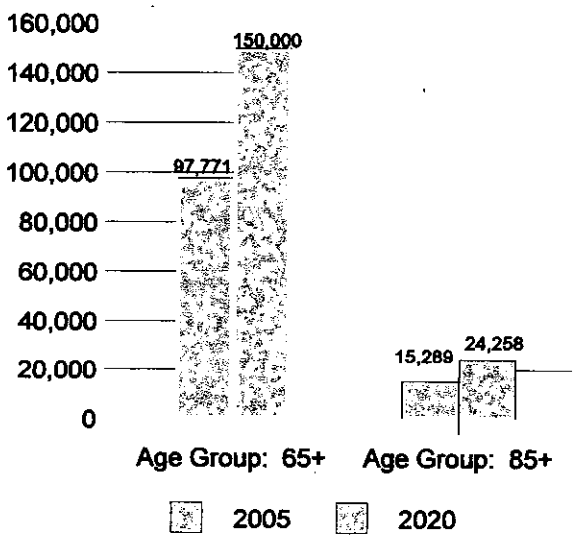
For the first time in history, following a downward trend of several years, ND is budgeting a *decrease* in Medicaid for individuals in Nursing Homes.

Passage of HB 1215 transfers the tax credit for LTCi from the long form to the short form.

Testimony on HB 1215
House Finance and Taxation Committee
January 18, 2005

Chairman Belter and members of the House Finance and Taxation Committee, thank you for the opportunity to testify on HB 1215. My name is Shelly Peterson, President of the North Dakota Long Term Care Association. We wish to go on record supporting HB 1215.

Currently North Dakota provides an incentive for individuals who purchase long term care insurance and who utilize the "long" form when filing their state income tax return. With the potential of the long form being eliminated, HB 1215 extends this credit to individuals utilizing the "short" form. This is an excellent approach to rewarding North Dakotans for properly planning for their long term care needs.



North Dakota has the highest proportion of individuals over the age of 85, the population most in need of long term care. In the next 15 years we will see an explosion of our aging population.

This demographic shift will have a profound affect on our state budget. In 2005, nursing facilities will care for 3,631 individuals at a cost of $157 million. Care for residents in need of twenty-four hour skilled nursing care accounts for about 87% of Medicaid expenditures for the long term care continuum and this budget item continues to increase each biennium.

North Dakotans have a history of planning for long term care. We purchase long term care policies at record levels and North Dakota is the fifth ranked state in terms of individuals paying for their nursing facility care. Thank goodness we have individuals who are responsible and paying their way.

We need to continue to offer this incentive of an income tax credit so North Dakota's future generation will take planning for long term care seriously. The more we entice individuals to plan and pay for their own care, the less burden for the state.

Lets continue to send a positive message of planning for long term care. Your serious consideration and passage of HB 1215 is appreciated.

Shelly Peterson, President
North Dakota Long Term Care Association
1900 North 11th Street
Bismarck, ND 58501
(701) 222-0660

TESTIMONY BEFORE THE HOUSE FINANCE AND TAXATION COMMITTEE

REGARDING HOUSE BILL 1215

JANUARY 18, 2005

Chairman Belter, members of the committee, I am David Zentner, Director of Medical Services for the Department of Human Services. I appear before you to provide information on this proposed legislation.

I am responsible for the administration of the Medicaid program in North Dakota. The Medicaid program is the primary source of funding for nursing facility care both nationally and in North Dakota. At the present time, the Medicaid program assists in the payment of nursing facility services for about 56% of all nursing facility residents. The current appropriation for nursing facility care is $318.4 million. The requested appropriation in the Executive budget for the 2005-2007 biennium is $348.8 million of which $122.6 million are general funds. It is anticipated that the cost of nursing facility care will double in 14 years or less. Attachment A details the growth in the cost of nursing facility care since 1980.

The number of North Dakota citizens over 85 years of age is expected to increase from about 15,300 in 2005 to about 24,250 by 2020, an increase of 9,000. Individuals over 85 years of age are those most likely to utilize nursing facility services.

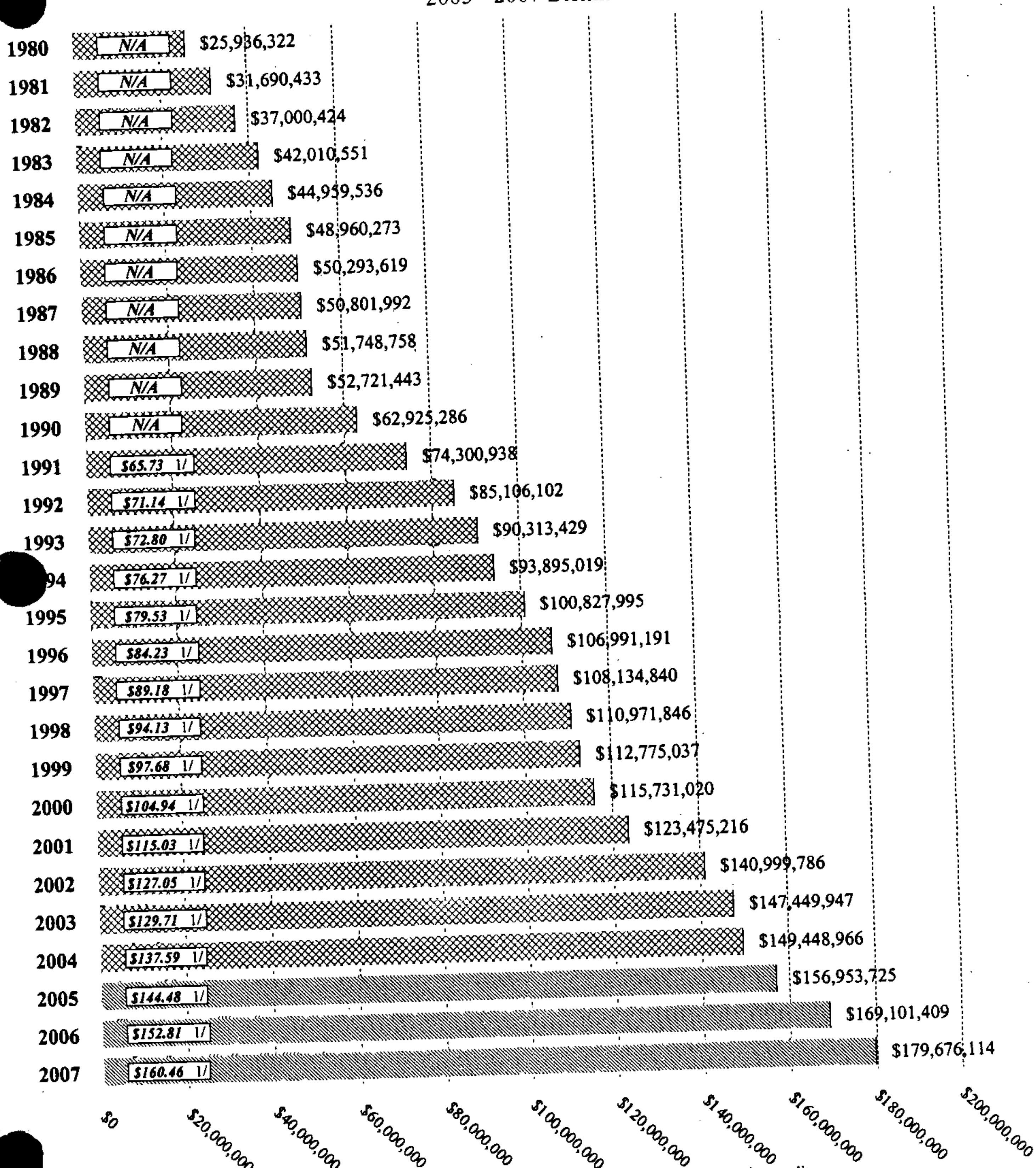
States have looked for ways to encourage individuals to properly plan for future long-term care services in order to lessen the burden on federal and state taxpayers. One of those strategies includes encouraging individuals to purchase long term care insurance, so there will be less reliance on Medicaid when the time comes for the elderly to access these services. One of the incentives being used by some states to encourage the purchase of long-term care insurance, is a tax credit or deduction for premiums paid by taxpayers.

It is likely that there will be no immediate reduction in the rate of growth for the nursing facility appropriation. However, if more individuals purchase insurance it is likely that the rate of growth will be reduced in the future.

I would be happy to respond to any questions you may have.

Attachment A

North Dakota Department of Human Services
Nursing Home Facilities
Fiscal Years 1980 - 2007 *
House Bill 1012
2005 - 2007 Biennium



* 1980 through 2004 represents actual expenditures. 2005 represents four months actual and eight months estimated expenditures. 2006 and 2007 represents estimated expenditures included in the Governor's budget.

1/ Average Daily Nursing Home Rate

FA-1/3/05-cj-hgw\0507legis\ltcx

TESTIMONY SUPPORTING HB 1215
January 18, 2005
9:15 a.m.

HOUSE FINANCE & TAXATION COMMITTEE
WESLEY BELTER, CHAIRMAN

Mr. Chairman and members of the House Finance & Taxation Committee:

My name is Norbert Mayer and I submit this testimony in support of HB 1215 on behalf of the North Dakota Association of Insurance and Financial Advisors.

Our association encourages the buying public to protect themselves with Long Term Care Insurance products that will help pay the bill with their assets instead of relying on the State of North Dakota tax base to support them in their old age.

Insurance gives them the opportunity to utilize alternate forms of care, such as assisted living and home health care, to keep them out of the skilled nursing home setting as long as possible. We buy insurance on our cars, our homes and on our lives for the same reasons that we should be buying Long Term Care Insurance. According to the North Dakota Human Services Department, the average monthly cost for long term care in North Dakota is $4395 or $146.50 per day. Long Term Care insurance, we believe, has successfully reduced the need for Medicaid payments to nursing homes to some degree presently but there is still a long way to go to prevent the train wreck in North Dakota as the baby boomers reach a period of older age.

The exploding costs of the Human Services Budget for Long Term Care is a looming concern for us in this state that has such a small population but such a high number of aging population. The private sector could have a very large impact on the overall cost to the taxpayers of North Dakota by having affordable Long Term Care Insurance in place on a larger number of residents of North Dakota. Currently many North Dakotans do take advantage of the tax credit on the long tax form, continuing this provision on the short tax form will have a very positive impact on the Department of Human Services Budget for Long Term Care.

We ask for your support on HB 1215.

Thank you very much, if there are any questions I would be happy to answer them at this time.

DEPARTMENT OF INSURANCE
STATE OF NORTH DAKOTA
600 East Boulevard Avenue Bismarck, ND 58505
Phone: (701) 328-2440 Fax: (701) 328-4880

Jim Poolman
Commissioner of Insurance

MEMORANDUM

TO:	REP. BELTER, CHAIRMAN, FINANCE & TAXATION COMMITTEE & MEMBERS OF THE COMMITTEE
FROM:	JIM POOLMAN
SUBJECT:	HB 1215 – ADDITIONAL INFORMATION REQUEST
DATE:	JANUARY 20, 2005

During the hearing on HB1215 relating to the Long Term Care Insurance Tax Credit there were questions raised about the demographics of those who purchase this type of insurance, and what typical "return on investment" the state of North Dakota may get back on the credit.

We have found a study that we believe will give you very valuable information related to these questions. This study is provided by the Health Insurance Association of America. We have highlighted and flagged the appropriate information in the report that relate to the questions that were asked in the Committee hearing.

We hope this information is valuable. As always, we stand ready to provide any information at any time or answer any questions.

HIAA®

HEALTH INSURANCE ASSOCIATION OF AMERICA

TAX DEDUCTIBILITY OF LONG-TERM CARE INSURANCE PREMIUMS

IMPLICATIONS FOR MARKET GROWTH AND PUBLIC LTC EXPENDITURES

(SUMMARY OF RESEARCH FINDINGS)

Marc A. Cohen, Ph.D.
Maurice Weinrobe, Ph. D.

March 2000

555 13th Street NW ✔ Suite 600 East ✔ Washington DC 20004 ✔ 202-824-1600 ✔ http://www.hiaa.org

Preface

In September 1999, the Health Insurance Association of America (HIAA), a leader in the study of long-term care (LTC) insurance and public policy, commissioned researchers Marc A. Cohen, Ph.D. of LifePlans, Inc. and Maurice Weinrobe, Ph.D. professor of economics at Clark University, to undertake an examination of the impact of tax policies on LTC insurance coverage. More specifically, HIAA was interested in finding out the extent to which further tax enhancements for private LTC insurance would help Americans deal with the financing of their present and future long-term care needs.

The researchers projected the impact on LTC insurance coverage of a 100 percent above-the-line tax deduction for LTC policies. The study also estimated what the deductibility of LTC insurance premiums would cost in tax revenues foregone. Finally, the study gauged the savings in public expenditures that such a deduction might yield. It concludes that a 100 percent above-the-line federal tax deduction for LTC insurance premiums would significantly increase LTC insurance coverage and that the resulting savings in Medicaid spending would more than pay for the foregone tax revenues.

The study was augmented in March 2000, adding a new section describing the impact of tax deductibility on Medicaid spending in the 10 states with the largest senior populations.

Tax Deductibility of Long-Term Care (LTC) Insurance Premiums: Implications for Market Growth and Public Long-Term Care Expenditures

As baby boomers begin to enter their retirement years, and as lifespans continue to increase, America faces the challenge of providing long-term care to millions more of its citizens. Indeed, by 2030, 70 million elderly Americans (more than twice today's population of seniors) are likely to have some long-term care needs. Paying for these needs is (or should be) near the top of both our personal and public policy agendas.

Medicare does not provide coverage for long-term care. Medicaid covers only those who have depleted most of their assets and have very low incomes. Moreover, long-term care services are costly today and are likely to be more costly in the future. Given competing demands on public dollars, government programs alone are not likely to meet the nation's growing long-term care needs. LTC insurance can play a key role in filling the gap. Private policies offer a flexible and affordable way to cover the costs of the myriad of services that an older person may need, from nursing homes to adult day care to home-delivered meals.

Long-term care is the largest unfunded liability facing Americans today. Despite the tremendous need for long-term care protection, few people plan for their long-term care needs. As Congress struggles to preserve Social Security and Medicare, there is a developing consensus that action should be taken to encourage Americans to plan for their future long-term care needs. One method is to help make private policies more affordable. Federal tax policy can play a key role in this effort by lowering the effective cost of coverage and by signaling to consumers that it is in their clear interest to take personal responsibility for protecting themselves against potential long-term care costs.

A First Step: The Health Insurance Portability and Accountability Act

In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA). HIPAA clarified that for federal income tax purposes, LTC insurance is to be treated essentially the same as major medical insurance. More specifically HIPAA provided that:

- benefits from private LTC coverage, generally, are not taxable;
- employers can deduct the costs of establishing an LTC insurance plan for employees and contributions toward premiums;
- employer contributions to LTC premiums are excluded from the taxable income of employees; and,
- LTC insurance premiums (and out-of-pocket costs for LTC services) can be applied toward meeting the 7.5 percent threshold in the federal tax code for medical expense deductions. (Limits, based on the policyholder's age, are still placed on the total premium amount that can be applied toward the 7.5 percent threshold.)

HIPAA clearly raised awareness of the value of private long-term care insurance. However, in practical terms, the law's financial benefits accrue almost entirely to those who enjoy LTC coverage through the workplace (less than 20 percent of the LTC market).

Under HIPAA, an individual purchaser can only deduct premiums if he or she itemizes deductions and only to the extent that medical expenses exceed 7.5 percent of adjusted gross income. Internal Revenue Service (IRS) data show that only 4.5 percent of all filers use the medical-dental deduction. Accordingly, only an estimated 6 percent of LTC policy purchasers can take advantage of the deduction.

Benefits of 100 Percent Tax Deduction for LTC Policies

A 100 percent above-the-line deduction would affect millions of Americans because the full amount of the premium from a purchased LTC policy would be deductible from income, whether or not an individual itemizes deductions or has medical expenses above the 7.5 percent threshold. As discussed below, market expansions would also reduce reliance on public expenditures, especially in the Medicaid program.

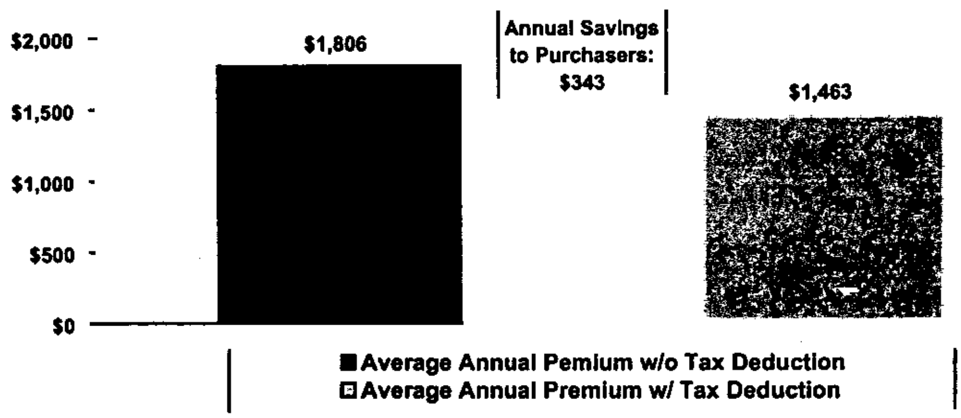
All current and future purchasers who file income taxes would benefit from a 100 percent above-the-line deduction because it means that consumers will be able to reduce their taxable income, resulting in lower taxes. Thus, the proposed deduction would effectively reduce the cost of premiums. Finally, proponents argue that an above-the-line tax deduction is easy to administer; is easy for consumers to understand; potentially benefits a large segment of the population; and is an effective means of encouraging the public to insure against potential LTC expenses.

Reductions in Cost of LTC Coverage

An above-the-line 100 percent federal tax deduction for LTC insurance premiums would effectively reduce the net premium costs for policies. For example, if a taxpayer is taxed at the 28 percent marginal rate, a deduction of $1,000 reduces taxes by $280, and an above-the-line deduction for LTC insurance premiums would be equivalent to a reduction in premium at that same rate.

The average annual premium for the purchase of an LTC policy in 1995 (the last year for which precise data are available) was $1,806. At that time, the average annual income of a LTC insurance purchaser was about $ $37,000, taxable at the marginal rate of 19 percent. For this individual, a 100 percent above-the-line tax deduction on LTC insurance premiums would have resulted in a 19 percent decrease in the cost of LTC coverage—a savings of $343 per year. (This also can be thought of as the average cost of the tax expenditure.) Thus, individuals who availed themselves of the deduction would, effectively, pay a reduced net premium of about $1,460.

Figure 1:
An above-the-line tax deduction for LTC Insurance reduces cost of coverage



Source: LifePlans, Inc., 1999.

Significant Increase in LTC Coverage

The intent and effect of an above-the-line deduction for LTC insurance premiums are to reduce the net cost of LTC insurance premiums. The extent to which this induces individuals to buy insurance depends largely on how sensitive they are to price changes for this type of insurance. Prior studies suggest that price is a major consideration in the purchase of LTC insurance. (HIAA's 1995 study of LTC purchasers shows that the most common reason for not purchasing LTC insurance is its cost.)

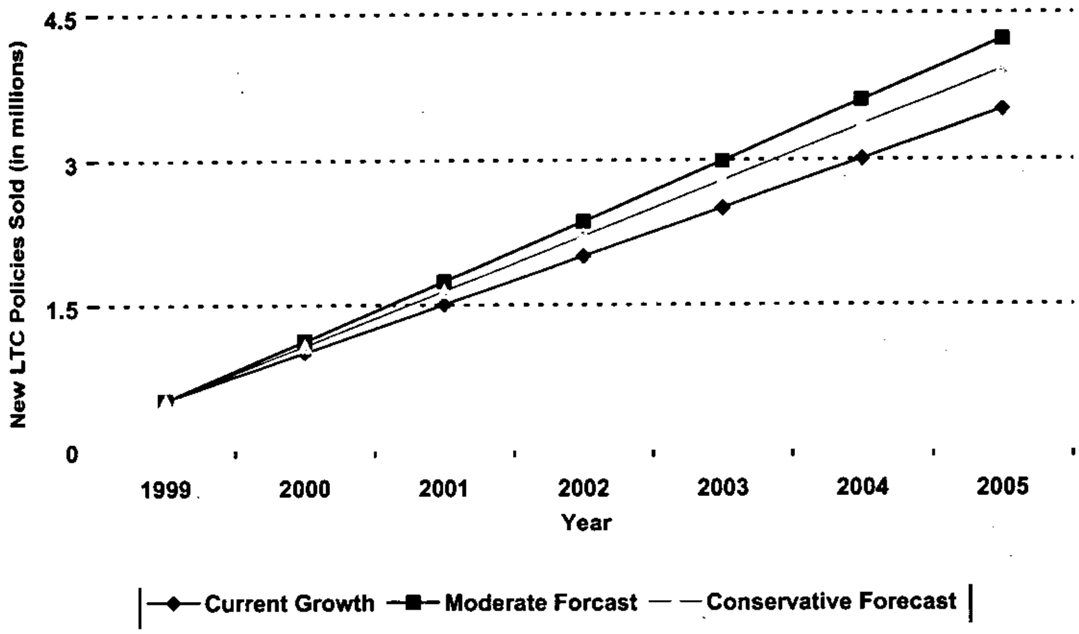
Changes in the demand for a good or service in response to a change in its net cost is described by that good's "price elasticity of demand." For example, if insurance premiums increase by 10 percent and the quantity of policies demanded declines by 15 percent, the elasticity of demand is -1.5: for every 1 percent increase in price, the quantity demanded declines by 1.5 percent.

Each year, starting with 1991 and ending with 1996, about 500,000 new LTC insurance policies were sold. By 1996, about 5 million policies had been sold (HIAA, 1998). If this trend continues, absent any change in the tax status of the insurance, by 2005 the annual growth rate in the market will be about 6 percent, and total polices sold will rise to about 9.5 million.

An above-the-line tax deduction would bring about a net decrease in LTC insurance premiums, which should encourage growth in the market. Applying price elasticity of demand estimates for LTC insurance of between -0.75 (conservative forecast) and -1.25 (moderate forecast), an average price decline of 19 percent would lead to a 14 to 24 percent increase in the number of insurance policies purchased. This represents an estimated increase in annual sales—above and beyond current growth—of between

70,000 and 120,000 policies. Taken in conjunction with current growth rates, between 2000-2005, in the presence of a 100 percent above-the-line tax deduction, up to 4.2 million new policies will have been sold. Total sales since the industry began selling policies would rise to roughly 10 million.

Figure 2
An above-the-line tax deduction would spur additional growth in LTC coverage



Source: LifePlans, Inc., 1999.

In addition, a change of this sort in federal tax policy would raise awareness of the risks and costs of long-term care. It would focus attention on the baby boomers' looming retirement. It would highlight the widespread availability of long-term care coverage and point the direction of government long-term care policy for the foreseeable future. Although this signaling effect is difficult to quantify, it is an important policy consideration. The growing awareness, affluence, and investment sophistication of retirees will all significantly affect attitudes and behaviors toward LTC insurance. If recent experience with the federal tax deduction for IRA contributions is any guide to the likely impact of an LTC insurance tax deduction the impact could be substantial. Growth in insurance purchases could easily exceed the 14 to 24 percent estimates on market growth due just to the effect of full deductibility on net premium cost.

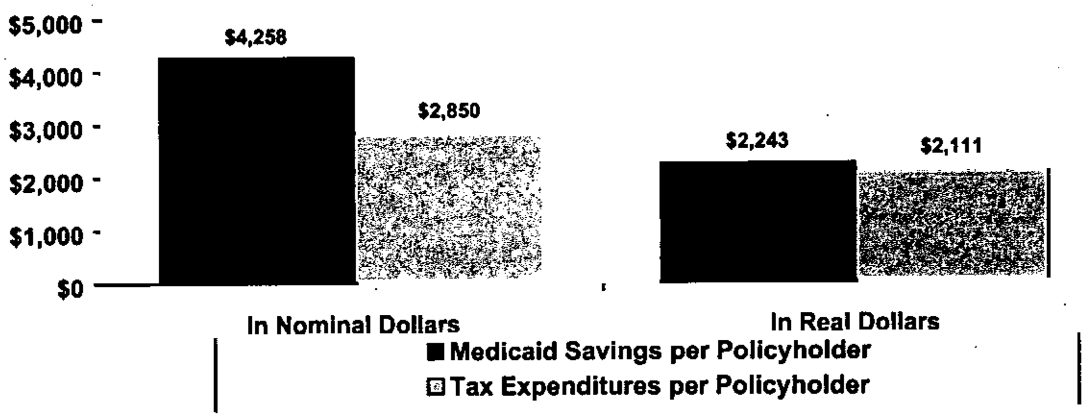
Medicaid Savings Would Offset the Cost of Full Deductibility for LTC Insurance

Private LTC coverage enables middle- to lower-income policyholders to access long-term care services without having to rely on Medicaid. In 1995, 68 percent of new private LTC purchasers had incomes below $35,000; these same purchasers had average assets valued at $63,000 (HIAA/LifePlans, 1995). Without the protection of long-term care insurance, 13 percent of these individuals would be likely to "spend down" to Medicaid eligibility levels if they ever needed long-term care. Their private LTC coverage, however, would help them avoid Medicaid, thereby saving public expenditures.

To calculate annual Medicaid savings per policyholder, we estimated how much Medicaid would have to spend on policyholders under two scenarios: (1) in the presence of LTC insurance, and (2) in the absence of LTC insurance. We found that on average, for every insured policyholder, Medicaid saves $6,148. We then multiplied this figure by a projection of the number of LTC policies sold annually after enactment of full deductibility: 570,000 (under a conservative scenario) and 620,000 (a still moderate estimate). This calculation yielded annual Medicaid savings of $3.5 billion to $3.8 billion. The aggregate annual tax expenditure cost of the tax deduction is projected at between $3.1 and $3.5 billion over the five-year period following enactment.

These comparisons are in "nominal" dollars (a simple comparison of total savings to total revenue foregone). However, there would be a significant lag between the beginning of tax benefits and the eventual generation of Medicaid savings. While tax expenditures are counted from the year of purchase of the LTC policy, Medicaid savings for each policyholder are realized on average 12 years after the purchase. It is therefore appropriate to make comparisons of Medicaid savings and tax expenditure costs in "real" dollars. To compare the total per-policyholder tax expenditure with projected Medicaid savings, future savings must be discounted (using a 6 percent annual discount rate) relative to current expenditures to reflect the time value of money.

Figure 3:
Medicaid savings would offset the cost of an LTC above-the-line deduction



Source: LifePlans, Inc., 1999.

In nominal terms, the projected cost per policyholder of the tax deduction is $2,850, and the Medicaid savings are $4,258. In real terms, these figures are $2,111 and $2,243, respectively. Thus, for every federal dollar of tax expenditure, Medicaid saves $1.06. Future Medicaid savings are likely be even greater because full tax deductibility for LTC insurance premiums will also have the educational and signaling effects described above.

State Treasuries Would Share in the Fiscal Benefits of Stronger Federal LTC Tax Incentives

The preceding analysis estimates the total Medicaid savings realized through accelerated growth in LTC coverage from 2000 through 2005 in the presence of a 100 percent above-the-line federal income tax deduction for LTC insurance premiums. Because state governments share the cost of Medicaid nursing home expenditures with the federal government, a portion of the Medicaid savings ultimately realized through more widespread LTC insurance coverage would also accrue to the states. While states may allow their own LTC insurance tax deductions or credits (20 states now do so), even states without such tax policies would benefit financially from federal tax deductibility of LTC insurance premiums by virtue of savings to the Medicaid programs.

State Medicaid savings would vary according to how much additional LTC coverage results from the deduction; the relative cost of Medicaid nursing home care; and the state/federal matching rate under the Medicaid program. To illustrate the fiscal benefits to states of full federal tax deductibility for LTC insurance, HIAA commissioned further research focusing on the 10 states with the largest senior populations. Figure 4, below, summarizes this analysis.

Figure 4
An Above-the-line federal tax deduction for LTC insurance would result in Medicaid savings for the states

	New LTC Policies Purchased (2000-2005)	State Share of Medicaid Savings per Policyholder	Lapse-Adjusted Real Medicaid Savings Per Policyholder (State Share)
California	43,000-47,000	$3,651	$1,935
Florida	59,000-65,000	$2,067	$1,096
Illinois	40,000-43,000	$2,819	$1,494
Michigan	21,000-23,600	$2,238	$1,186
New Jersey	11,000-12,200	$4,954	$2,626
New York	16,000-17,000	$4,447	$2,357
North Carolina	10,600-11,500	$1,796	$952
Ohio	29,600-32,200	$2,707	$1,435
Pennsylvania	41,000-45,000	$3,126	$1,657
Texas	31,000-33,500	$2,006	$1,063

Source: LifePlans, Inc.

These state Medicaid savings estimates assume that full federal deductibility would induce a 24% increase in LTC policy purchases. The final column of the table shows the state share of Medicaid savings discounted for the time value of money and adjusted for the expected rate of policy lapse. For these 10 states, the "real" Medicaid savings per policyholder ranges from $952 in North Carolina to $2,626 in New Jersey.

Twenty states (including California, New York, North Carolina, and Ohio) currently provide some kind of state tax incentive of their own for the purchase of LTC insurance. Other states (including Illinois, Michigan, New Jersey, and Pennsylvania) are considering LTC insurance tax measures. State income tax rates are lower than the federal rates, and state tax incentives tend to be more modest than the proposed federal tax deduction. Even so, state tax incentives could work in tandem with federal tax incentives to help make LTC insurance premiums even more affordable, increase LTC insurance coverage, and reduce long-term care expenditures.

Improved Quality of Life for Millions of Policyholders

Beyond the quantitative advantages of providing enhanced tax incentives for the purchase of private LTC coverage, there would also be significant qualitative benefits to policyholders, claimants, and their families. In addition to the peace of mind of knowing that there will be sufficient resources to pay for long-term care if needed, private LTC coverage can bring significant improvements in quality of life. Recent studies of policyholders, claimants, and informal caregivers suggest that the presence of LTC insurance can:

- delay or prevent institutionalization;
- enable easier access home care and/or assisted living;
- afford a greater choice of long-term care services and providers;
- ease the financial, physical, and emotional burdens on families providing care in the home; and
- preserve assets for heirs.

Conclusions

A 100 percent above-the-line federal tax deduction for LTC insurance premiums would reduce net premium costs, increase LTC coverage, and bring about Medicaid savings. The tax expenditure, in both nominal and real terms, would be offset by future reductions in Medicaid expenditures. Medicaid savings would accrue both to the states and the federal government. Thus, as individuals are encouraged to assume greater personal responsibility for meeting their future long-term care needs by purchasing private insurance, the fiscal pressures on the federal government and state governments will decline. This will help assure that the private sector piece of the long-term care financing puzzle will play an ever-growing and critical role in helping to address this important social policy issue.