

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 6569
BILL NUMBER: SB 226

DATE PREPARED: Dec 20, 1999
BILL AMENDED:

SUBJECT: Income tax deduction for health insurance premium.

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FUNDS AFFECTED: **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

STATE IMPACT	FY 2000	FY 2001	FY 2002
State Revenues		(43,500,000)	(83,800,000)
State Expenditures			
Net Increase (Decrease)		(43,500,000)	(83,800,000)

Summary of Legislation: This bill provides an income tax deduction for health insurance premiums paid by individuals and for premiums paid by sole proprietors, S corporation shareholders, or partners to the extent the premiums paid by these businesses are not deductible under the federal Internal Revenue Code.

Effective Date: January 1, 2001.

Explanation of State Expenditures: There will be some administrative expenses for the Department of State Revenue to revise tax forms, instructions, and computer programs. These expenses will be covered under the Department's existing budget.

Explanation of State Revenues: *This bill provides for two individual income tax deductions for medical insurance premiums which will reduce revenue collections by \$43.5 M in FY 2001 and \$83.8 M in FY 2002.* (A) Individuals are allowed to deduct the amount that they pay for insurance premiums covering medical care for the taxpayer, the taxpayer's spouse, and the taxpayer's dependents. (B) The bill also provides an income tax deduction for the amount of premiums paid by sole proprietors, S corporation shareholder, or partners to the extent that the premiums paid by these businesses are not deductible under the Internal Revenue Code (IRC).

(A) *The deduction for insurance premiums paid by individuals is estimated to reduce revenue collections by \$40.5 M in FY 2001 and \$81.1 M in FY 2002. With an effective date of January 1, 2001, it is anticipated that individuals may adjust their withholding to account for this new deduction. Therefore, the FY 2001 revenue lost reflects the first six months withholding for tax year 2001. Based on data from the Office of National Health Statistics, it is projected that employee contributions to private health insurance in Indiana would be approximately \$2.4 B in 2001. Health insurance expenditures by private health insurance companies have been increasing at 7.95% annually. The revenue loss from this deduction will continue to grow as premiums increase over time.*

(B) *The deduction for insurance premiums paid by sole proprietors, S corporation shareholders, or partners which are not deductible under the federal Internal Revenue Code (IRC) will reduce revenue collections by \$3 M in FY 2001, \$2.7 M in FY 2002 and \$1.2 M in FY 2003.*

The IRC deduction for these expenses has increased over the last three years. The percentages of premiums paid by the self-employed person eligible for the federal deduction are outlined in the following table.

Tax Year	Percent of Premiums Deductible
2000	60%
2001	60%
2002	70%
2003 & Beyond	100%

This bill would allow a state deduction in the amount which is not covered under the federal deduction. (This is because the federal deduction flows through to the calculation of federal adjusted gross income which is the starting point of calculating Indiana income taxes.) Under the current federal schedule, the new state deduction is reported below along with the corresponding revenue loss. Beginning in tax year 2003, this deduction would not generate any additional revenue loss since the federal deduction is set at 100% of the medical care insurance expenses. This deduction is effective for tax years beginning January 1, 2001, and would affect revenue collections starting in FY 2001 (due to changes in estimated payments).

Tax Year	Current Federal Deduction	New State Deduction	Tax Year Revenue Loss	Fiscal Year Revenue Loss
2001	60%	40%	(\$3.0 M)	(\$3.0 M)
2002	70%	30%	(\$2.4 M)	(\$2.7 M)
2003	100%	0	0	(\$1.2 M)

Individual income tax revenue is deposited in the General Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: Counties with a local option income tax will experience a loss of revenue as a result of this deduction.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: