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FISCAL IMPACT STATEMENT

LS 6593

BILL NUMBER: HB 1628

NOTE PREPARED: Dec 8, 2004

BILL AMENDED:

SUBJECT: Medical Expense Deduction.

FIRST AUTHOR: Rep. Stevenson

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: **GENERAL**
 DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides a deduction from Adjusted Gross Income for eligible medical expenses.

Effective Date: January 1, 2005 (retroactive).

Explanation of State Expenditures: The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate this deduction. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Explanation of State Revenues: *Summary:* The bill would reduce state Adjusted Gross Income (AGI) Tax liabilities for individual taxpayers who have out-of-pocket medical care expenses and insurance premium expenses that are eligible for the federal itemized deduction for medical and dental expenses. The revenue loss due to this bill could potentially total as much as \$88.3 M beginning in FY 2006. Growth in the deduction could potentially range from 8% to 12% annually thereafter based on recent annual trends in medical expenses and health insurance premiums.

Background: The bill establishes a deduction from Indiana AGI for medical care expenses paid by an individual taxpayer that are deductible under the federal itemized deduction for medical and dental care expenses. The deduction from Indiana AGI is limited to eligible expenses paid during the taxable year exceeding \$300 but not in excess of: (1) \$3,000 for a single filer with no dependents; or (2) \$3,000 multiplied by the total number of the following individuals: (a) the taxpayer, (b) the taxpayer's spouse, and (c) each of

the taxpayer’s dependents. For example, a joint filer with two dependents would be entitled to deduct annual medical expenses in excess of \$300 and up to \$12,000. The expenses must be for the care of the individual, the individual’s spouse, or dependents of the individual. Expenses that are eligible for the federal itemized deduction include: (1) out-of-pocket medical care expenses and (2) premiums paid by the individual for health insurance coverage, Medigap or Medicare Supplement insurance, or long-term care insurance. Eligible health insurance premiums include: (1) premium expenses of individuals purchasing private non-group health coverage and (2) employee premium expenses related to employer-provided health coverage as long as the employee premiums are not paid with “pre-tax income. This would also include premiums paid by individuals for coverage through the Indiana Comprehensive Health Insurance Association (ICHIA). Under the bill, the deduction could not be claimed for premiums paid for “Indiana Partnership long-term care insurance as these premiums already may be deducted in computing Indiana AGI. The deduction is effective beginning tax year 2005. As a result, the fiscal impact could potentially begin in FY 2006.

The estimated revenue loss from the deduction is attributable to: (1) out-of-pocket medical care expenses; (2) premiums paid by individuals for private non-group health coverage; (3) employee-paid share of the premium cost of employer-provided health coverage; (4) premiums paid by individuals for Medigap or Medicare Supplement insurance policies; and (5) premiums paid by individuals for long-term care insurance policies. The table below reports the estimated revenue loss for the first year of the deduction by expense type. The fiscal impact of this deduction could potentially increase 8% to 12% annually based on recent annual trends in medical expenses and health insurance premiums. The growth rate would depend on a number of factors including year-to-year changes in health insurance coverage rates, employee participation in pre-tax payment plans, and the extent to which employers providing health insurance benefits share the cost of premium increases with covered employees.

Type of Expense	Revenue Loss from Expense Deduction
Out-of-Pocket Medical Care Expenses	\$28.8 M
Private Non-Group Health Coverage	3.7 M
Employer-Provided Health Coverage	45.5 M
ICHIA Coverage	0.8 M
Medigap/Medicare Supplement Coverage	5.4 M
Long-Term Care Coverage	4.1 M
Total	\$88.3 M

Estimation Background: Deductible expense and premium totals are estimated based on *Census 2000* population counts for Indiana and statistical results from various health expense and insurance surveys. Information used for the different estimates is outlined below.

Out-of-Pocket Expenses: The deductible out-of-pocket expense total is estimated based on survey research estimating the distribution of out-of-pocket expenses by marital/family status.

Private Non-Group Health Coverage: The deductible premium total for private non-group coverage is estimated

based on survey research suggesting that roughly 5% of the population under the age of 65 is covered by such insurance policies, with current annual premiums averaging about \$1,530 for single coverage and \$2,890 for family coverage. In addition, this is adjusted to account for individuals who purchase private non-group coverage but already utilize the deduction from federal gross income for self-employed health insurance premiums. In 2001, 73,149 federal filers residing in Indiana claimed \$170.3 M in health premiums under this deduction. These premiums are excluded from the estimate.

Employer-Provided Coverage: Deductible premiums for employees with employer-provided coverage are estimated based on survey research suggesting that about 70% of the population under the age of 65 is covered by employer-provided health insurance, with the current employee share of premium cost averaging about \$560 for single coverage and \$2,660 for family coverage. This estimate is also based on survey research estimating that about 28% of workers are employed by businesses that offer “cafeteria plans” enabling workers to pay for employer-provided health insurance benefits with “pre-tax” income. Thus, the estimated revenue loss attributable to premiums paid by workers for employer-provided coverage is adjusted to account for this group. To do so, it is assumed that government workers and 28% of private sector employees currently pay health insurance premiums with “pre-tax” income.

ICHIA Coverage: Deductible ICHIA premiums are estimated based on annualized premium totals reported for the January-September 2004 period, and average ICHIA client totals for the same period. These totals are adjusted to exclude clients whose premiums are paid by the Indiana Department of Health.

Medigap/Medicare Supplement Coverage: Deductible premiums for Medigap/Medicare Supplement coverage are estimated based on survey research suggesting that approximately 30% of the population 65 and older purchase this insurance coverage. The estimate assumes an annual premium of \$1,000. This is based on Medigap/Medicare Supplement insurance pricing information provided by the Indiana Department of Insurance.

Long-Term Care Coverage: The deductible premium total for long-term care coverage is estimated based on survey research estimating that Indiana market penetration rates for long-term care insurance ranges from 10% to 14%, with a reported average premium of about \$1,806 per year. The estimate assumes an average deduction of \$700 since the federally deductible premium is limited based on the age of the taxpayer. The amount eligible for the federal deduction ranges from \$260 for taxpayers 40 or younger, to \$3,250 for taxpayers 71 or older. The estimate also excludes Indiana Partnership policies which are covered by a separate tax deduction under current statute.

Explanation of Local Expenditures:

Explanation of Local Revenues: The proposed deduction could potentially decrease taxable income. As a result, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) could potentially experience a significant decrease in revenue from these taxes.

State Agencies Affected: Department of State Revenue.

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

Information Sources: OFMA Income Tax databases, 1998-2001. *Census 2000, Age Distribution of Population, Indiana*, Summary File 1, <http://www.census.gov/>. Agency for Healthcare Research and Quality.

2001 Full Year Consolidated Data File (HC-020). Medical Expenditure Panel Survey Household Component Data, <http://www.meps.ahrq.gov/>. Kaiser Family Foundation, *The Economic Downturn and Changes in Health Insurance Coverage 2000-2003*, September 2004, <http://www.kff.org/>. Kaiser Family Foundation, *Update on Individual Health Insurance*, August 2004. Kaiser Family Foundation, *Employer Health Benefits Annual Survey*, 1999& 2004. Bureau of Labor Statistics, *Employment, Hours & Earnings (NAICs Based Data) - Indiana: September 2004*. Health Insurance Institute of America (HIAA), *Long-Term Care Insurance in 1997-1998*. HIAA, *Long-Term Care Insurance in 1998-1999*. HIAA, *Tax Deductibility of Long-Term Care Insurance Premiums*, March 2000. Milbank Memorial Fund, *Long-Term Care for the Elderly with Disabilities*, August 2000. Indiana Long-Term Care Insurance Program statistical summaries. Mary Ann Hack, Family and Social Services Administration, (317) 232-1034. Centers for Medicare and Medicaid Services, *Trends in the MCBS 1992-2000*, <http://www.cms.hhs.gov/>. Indiana Department of Insurance, *Senior Health Insurance Information Program*, <http://www.in.gov/idoi/shiip>. Ann Bingman, Affiliated Computer Systems.

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