NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: Senate Bill 1382 (First Edition)

SHORT TITLE: Long-Term Care Tax Credits

SPONSOR(S): Senator Forrester

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

	($Million)				
	FY 2002-03	**FY 2003-04**	**FY 2004-05**	**FY 2005-06**	**FY 2006-07**
REVENUES					
General Fund					
LTC Insurance Credit*			**(8.5)**	**(9.4)**	**(10.3)**
LTC Needs Credit*	**(71.5)**	**(83.9)**	**(99.1)**	**(112.1)**	**(117.2)**
Total G.F.	**(71.5)**	**(83.9)**	**(107.6)**	**(121.5)**	**(127.5)**

EXPENDITURES

POSITIONS:

PRINCIPAL DEPARTMENT(S) &
PROGRAM(S) AFFECTED: Department of Revenue; Department of Insurance

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 2002.

* LTC = Long Term Care

BILL SUMMARY

Section 1 of the bill removes the 2003 sunset on the individual income tax credit for long-term care insurance premiums. Section 2 of the bill creates a new individual income tax credit for individuals with long term care needs or for caregivers of those with long-term care needs. The nonrefundable credit is $1,500 in tax year 2002, $2,000 in 2003, $2,500 in 2004, and $3,000 in 2005 and after (nonrefundable means the amount of the tax credit that exceeds the amount of tax owed by the taxpayer is not refunded to the taxpayer). The credit amount is reduced when the adjusted gross income of the caregiver or the individual with long-term care needs is above $150,000 for married filing jointly or $75,000 for other tax filers. The credit is for long-term care of individuals with the following conditions: (1) age 6 and above that are unable to perform three of the six defined activities of daily living (ADL); (2) age 6 and above with severe cognitive impairment that are unable to perform one ADL; (3) between age 2 and 6 that are unable to perform two of the three activities of eating, transferring, or mobility, and (4) under age 2 that require durable medical equipment.

BACKGROUND

Federal

The Internal Revenue Code has several provisions that assist taxpayers with long-term care costs:

- A taxpayer may deduct unreimbursed expenses for long term care services if the cost of such services exceeds 7.5% of adjusted gross income (AGI).
- Also deductible is a portion of premium costs for long-term care policies, subject to the same 7.5% AGI threshold. The amount of premium that can be deducted increases with the age of the taxpayer beginning with $230 at age 40 and up to $2,860 over age 70.
- An additional standard deduction is given to those taxpayers over age 65 or taxpayers/dependents of any age who are blind.
- The child and dependent care credit is equal to 20% to 30% of expenses paid for the care of a dependent to allow the taxpayer to work. The credit maximum is $2,400 and is based on the taxpayer's AGI. The credit covers (1) children under age 13, (2) a spouse that is mentally or physically incapable of caring for him or herself, and (3) a dependent, regardless of age, that is mentally or physically incapable of caring for him or herself.
- Self-employed taxpayers may include long-term care insurance premiums in their deduction for health insurance.

State

According to the Health Insurance Association of America, North Carolina is one of twenty-two states with long-term care incentives. The 1998 General Assembly established the individual income tax credit for premiums paid on long-term care insurance. The nonrefundable credit is equal to 15% of the premium costs paid during the taxable year but not to exceed $350 for each qualified long term care insurance contract. The credit is disallowed or reduced if (1) the premium payments are deducted from gross income, (2) the premium payment is claimed as a deduction for health insurance costs by a self employed individual, or (3) the premium payment is claimed as a deduction for medical care expenses. The credit was available to taxpayers beginning in tax year 1999. (Data on the credit is provided in the Assumptions and Methodology section.)

North Carolina also has a credit for the disabled. GS 105-151.18 provides a credit to taxpayers retired on disability and who were permanently and totally disabled at the time of retirement. The base credit is $80 for married filing jointly and qualifying widow(er) with dependent children, $64 for head of household, $48 for single, and $40 for married filing separately. The credit is reduced by $4 for each $1,000 above the base amounts listed in the statutes. In tax year 2000, $494,692 in disabled credits were taken.

ASSUMPTIONS AND METHODOLOGY

Long-Term Care Insurance Credit

The best data available to determine the cost of continuing the long-term care insurance credit beyond 2003 is the actual credit amounts for 1999 and 2000 and the Department of Insurance survey results for 1997 and 1998. In unedited data on the long-term care credit for tax years 1999 and 2000 recently released by the Tax Research Division of the Department of Revenue, 20,369 taxpayers claimed $4,023,230 in long-term care credits in 1999. This number grew in tax year 2000 to 28,263 taxpayers claiming $5,761,192 in long-term care credits.

The number of tax credits taken is a fraction of the actual policies in the state. The main source for long-term care information has been the National Association of Insurance Commissioners (NAIC) Long Term Care Experience Reporting Forms B and C. However, this data proved inadequate in the initial estimation of the long-term care insurance credit in 1998 due to errors in state by state reporting of the number of covered lives. Wanting a more accurate count of the long-term care insurance policies in the state, the Fiscal Research Division of the General Assembly requested the Department of Insurance to provide this information. Eighty- five (85) of the 96 insurance companies surveyed by the Department's Life and Health Division reported 64,236 covered lives in 1997 and an annual weighted premium of $1,246. In 1998, 59 insurance companies had 69,346 covered lives and an annual weighted premium of $1,178. Unfortunately, the Department of Insurance discontinued their long-term care insurance survey after 1998.

Without the state survey, the NAIC database is the only source for the number of long-term care policies. Again, there are too many questionable data elements to make the database useful. The NAIC reported 49 insurance companies in North Carolina had 70,568 long-term care insurance covered lives in 1999. However, 34,000 of the covered lives were with a company that reported only 92 covered lives the previous year. In 2000, the same company reported no long-term care policies in North Carolina. The NAIC reported a drop in covered lives to 64,524 in 2000, a trend counter to the national pattern. <u>The Department of Insurance has again been asked by Fiscal Research to survey insurance companies for the number of long-term care policies in the state, but this data will not be obtained in time for this fiscal note.</u>

As stated above, the number of covered lives was 64,236 in 1997 and 69,346 in 1998. The 8% growth between 1997 and 1998 is in line with the 8 to 12% annual growth projected for the next five years by Dr. Marc Cohen of LifePlans, Inc., a long-term care insurance service, risk management, and research company. Dr. Cohen also projects premium prices will grow 2% a year. In the following chart, it is assumed the number of covered lives will grow 8% a year and the amount of credit will grow 2% annually until 2006. The number of actual credits taken was approximately 27% of covered lives in 1999 and 35% in 2000. The 1998 fiscal note for establishing the credit estimated a 54.2% participation rate based on income. The lower 35% participation rate may reflect the ineligibility of taxpayers due to their use of federal tax deductions or from employer provided policies. In a March 2002, speech to the Center for Medicare and Medicaid Services, Dr. Cohen stated that the employer provided long term care insurance market nationwide grew 32% in the 1990's. Thirty-five hundred (3,500) employers in the United States now cover 800,000 employees with long-term care insurance. An estimated 35% participation rate for this credit is assumed for the next five years.

	Covered Lives	% Claiming Credit	# Claiming Credit	Credit Amount Per Claim	Total Credit
1997	64,236	-	-	-	-
1998	69,346	-	-	-	-
1999	74,894	27%	20,369	$197.52	$4,023,285
2000	80,885	35%	28,263	$203.84	$5,761,130
2001	87,356	35%	30,575	$207.92	$6,356,972
2002	94,344	35%	33,021	$212.08	$7,002,841
2003	101,892	35%	35,662	$216.32	$7,714,329
2004	110,043	35%	38,515	$220.64	$8,498,105
2005	118,847	35%	41,596	$225.06	$9,361,512
2006	128,355	35%	44,924	$229.56	$10,312,642

The fiscal impact of section one of SB 1382, extending the long-term care insurance credit, is not realized until FY 2004-05. The 2004 credit will be taken on returns filed in the spring of 2005, thus a General Fund loss of $8.5 million (see chart above) for FY 2004-05. The estimated loss for FY 2005-06 is $9.4 million and the estimated loss is $10.3 million for FY 2006-07.

Long-Term Care Needs Credit

The proposed state tax credit for individuals with long-term care needs is almost identical to a federal credit proposed by President Clinton in 1999. The Lewin Group, a national health and human services consulting firm, analyzed the Clinton proposal that offered a nonrefundable $1,000 credit for long term care needs. A major category of credit recipients in SB 1382 and the 1999 Clinton proposal are those unable to perform three of the six activities of daily living (ADL): eating, toileting, transferring, bathing, dressing, and continence. In “An Analysis of the President’s Proposed Long Term Care Tax Credit” for the Alzheimer’s Association in 1999, the Lewin Group estimated credit eligibility by using the 1994 National Health Interview Survey Disability Supplement and the March 1998 Current Population Survey. Their research found 5.2 million US citizens eligible for the credit – 3,930,000 in the community and 1,310,000 in nursing facilities. However, The Lewin Group estimated only 39.2% of those in the community and 9.9% of those in nursing homes would take advantage of the credit. Many of those eligible for the credit do not pay income taxes due to low income or Social Security income that is not taxed.

For North Carolina, the Lewin report said there were 114,000 persons in the community eligible for the credit in 1998. The Lewin Group estimated that two-thirds of those receiving the credit in the community would be the spouses or caregivers of the qualifying individuals and that half of the credit recipients would be over age 65. The report broke down the credit eligible recipients in the community by income stated as a percent of federal poverty level (FPL). It is assumed that the North Carolina caregiving and care receiving population will mirror the nation. Since the most likely family size for this group is two, the caregiver and the care receiver, the FPL for a family of two is used. According to the US Census Bureau, the FPL in 2002 is $11,940. The income column in the charts below is the midpoint of the FPL range. For example, the income used for <100% is 50% of the 2002 FPL of $11,940. Based on the experience of the last five years, the FPL is projected to grow 2.4% each year in this fiscal note.

The chart below shows those eligible for the long term care needs credit by income level in 2002. The Lewin Group’s Home and Community Based Services (HCBS) Population Tool, used to calculate the number of persons with ADL needs in a state, projects that the number of persons with three or more ADLs in North Carolina will grow 1.86% a year from 2002 to 2010. This 1.86% a year growth rate is also applied to the 1998 eligible estimate of 114,000 to get an adjusted tax year 2002 rate of 122,482 persons in the community that are eligible for the long-term care needs credit.

% of FPL	Income	NC Eligible
< 100%	$5,970	30,620
100% to 149%	$14,925	37,969
150% to 199%	$20,895	20,822
200% to 299%	$29,850	13,473
300% to 499%	$47,760	7,349
500%>	$59,700	12,248
Total		122,482

Since the credit is nonrefundable and has a maximum threshold, the number receiving the credit is smaller than 122,482 in 2002 and the amount of the credit received is smaller than $1,500. The Lewin Group study does not provide a breakdown by tax filing status, thus this fiscal note assumes that the average taxpayer seeking this credit will be married filing jointly. It is assumed that the taxable income for this group will be reduced by a $5,500 standard deduction ($6,000 in 2003) and two personal exemptions equal to $5,000. After deducting the standard deduction and personal exemptions, the 25% of the group with income below the poverty level will be ineligible for the credit, because they have no taxable income. Those with incomes between 100% FPL and 300% FPL will receive less than the maximum credit each year because their amount of tax owed is less than the credit (see following charts). Since The Lewin Group gave no information about those with incomes above 500% FPL, this note assumes the same distribution of taxpayers as found in the North Carolina 2000 tax returns. Those between $50,000 to $150,000 taxable income will receive the full credit, because their tax owed is greater than the credit. For those with taxable incomes between $150,000 and $200,000, SB 1382 reduces their credit $100 for every $1000 over $150,000. The average taxable income in 2000 for those between $150,000 and $200,000 was $172,000. A taxpayer with a $172,000 taxable income would not be eligible for the credit until the credit reaches $2500 in 2004. Taxpayers with taxable incomes above $200,000 will not receive the credit because of the phase out.

2002 Federal Poverty Level Family of 2 =	$11,940	Community Eligible	Deduction/ Exemption	Taxable Income	Eligible Credit	2002 Credit Max	General Fund Loss
< 100% FPL	$5,970	30,620	$10,500	$0	$0	$1,500	$0
100% to 149%	$14,925	37,969	$10,500	$4,425	$266	$1,500	$10,080,848
150% to 199%	$20,895	20,822	$10,500	$10,395	$624	$1,500	$12,986,602
200% to 299%	$29,850	13,473	$10,500	$19,350	$1,161	$1,500	$15,642,125
300% to 499%	$47,760	7,349	$10,500	$37,260	$1,500	$1,500	$11,023,344
500%>		12,248					
		10,533	$10,500	$50k - $150k	$1,500	$1,500	$15,800,126
		612	$10,500	$150k - $200k	$0	$1,500	$0
		1,102	$10,500	>$200k	$0	$1,500	$0
TOTAL		122,482					$65,533,045

2003 Federal Poverty Level						2003	General
Family of 2 =	$12,227	Community	Deduction/	Taxable	Eligible	Credit	Fund
		Eligible	Exemption	Income	Credit	Max	Loss
< 100% FPL	$6,113	31,190	$11,000	$0	$0	$2,000	$0
100% to 149%	$15,283	38,676	$11,000	$4,283	$257	$2,000	$9,939,300
150% to 199%	$21,396	21,209	$11,000	$10,396	$624	$2,000	$13,230,036
200% to 299%	$30,566	13,724	$11,000	$19,566	$1,174	$2,000	$16,111,256
300% to 499%	$48,906	7,486	$11,000	$37,906	$2,000	$2,000	$14,971,171
500%>		12,476					
		10,729	$11,000	$50k - $150k	$2,000	$2,000	$21,458,678
		624	$11,000	$150k - $200k	$0	$2,000	$0
		1,123	$11,000	>$200k	$0	$2,000	$0
TOTAL		124,760					$75,710,441

2004 Federal Poverty Level						2004	General
Family of 2 =	$12,520	Community	Deduction/	Taxable	Eligible	Credit	Fund
		Eligible	Exemption	Income	Credit	Max	Loss
< 100% FPL	$6,260	31,770	$11,000	$0	$0	$2,500	$0
100% to 149%	$15,650	39,395	$11,000	$4,650	$279	$2,500	$10,991,167
150% to 199%	$21,910	21,604	$11,000	$10,910	$655	$2,500	$14,141,743
200% to 299%	$31,300	13,979	$11,000	$20,300	$1,218	$2,500	$17,026,212
300% to 499%	$50,080	7,625	$11,000	$39,080	$2,500	$2,500	$19,062,043
500%>		12,708					
		10,929	$11,000	$50k - $150k	$2,500	$2,500	$27,322,262
		635	$11,000	$150k - $200k	$300	$2,500	$190,620
		1,144	$11,000	>$200k	$0	$2,500	$0
TOTAL		127,080					$88,734,047

2005 Federal Poverty Level						2005	General
Family of 2 =	$12,820	Community	Deduction/	Taxable	Eligible	Credit	Fund
		Eligible	Exemption	Income	Credit	Max	Loss
< 100% FPL	$6,410	32,361	$11,000	$0	$0	$3,000	$0
100% to 149%	$16,026	40,128	$11,000	$5,026	$302	$3,000	$12,099,919
150% to 199%	$22,436	22,005	$11,000	$11,436	$686	$3,000	$15,099,061
200% to 299%	$32,051	14,239	$11,000	$21,051	$1,263	$3,000	$17,984,672
300% to 499%	$51,282	7,767	$11,000	$40,282	$2,607	$3,000	$20,249,443
500%>		12,944					
		11,132	$11,000	$50k - $150k	$3,000	$3,000	$33,396,548
		647	$11,000	$150k - $200k	$800	$3,000	$517,776
		1,165	$11,000	>$200k	$0	$3,000	$0
TOTAL		129,444					$99,347,417

2006 Federal Poverty Level						2006	General
Family of 2 =	$13,128	Community Eligible	Deduction/ Exemption	Taxable Income	Eligible Credit	Credit Max	Fund Loss
< 100% FPL	$6,564	32,963	$11,000	$0	$0	$3,000	$0
100% to 149%	$16,410	40,874	$11,000	$5,410	$325	$3,000	$13,268,221
150% to 199%	$22,974	22,415	$11,000	$11,974	$718	$3,000	$16,104,071
200% to 299%	$32,820	14,504	$11,000	$21,820	$1,309	$3,000	$18,988,586
300% to 499%	$52,513	7,911	$11,000	$41,513	$2,693	$3,000	$21,307,652
500%>		13,185					
		11,339	$11,000	$50k - $150k	$3,000	$3,000	$34,017,723
		659	$11,000	$150k - $200k	$800	$3,000	$527,407
		1,187	$11,000	>$200k	$0	$3,000	$0
TOTAL		131,852					$104,213,659

Based on the charts above, 90,148 taxpayers in the community will be eligible for $65.5 million in credits in tax year 2002. These credits will be claimed on returns filed beginning January 2003, thus the fiscal impact will be in FY 2002-03.

How many nursing home residents will be eligible for the credit? Using North Carolina's percentage of the US population, the state should have 2.87% of the 1,310,000 US residents eligible for the credit in 1998 or 37,597. As stated above, the number of persons with 3 or more ADLs has a growth rate of 1.86% a year. Using this rate, the 37,597 in 1998 would equal 40,473 in 2002. However, the Lewin study found that only 9.9% of those in nursing homes would take advantage of the credit because their income is Social Security or pension income that is not taxed. At a 9.9% participation rate, only 4,007 nursing home taxpayers would take the credit. Since no income data exist for these tax credit participants, this fiscal note will assume they will receive the full credit amount as shown in the chart below.

	Nursing Home Eligible	9.9% Take Credit	Credit Amount	G.F. Revenue Loss
1998	37,597			
1999	38,296			
2000	39,009			
2001	39,734			
2002	40,473	4,007	$1,500	$6,010,275
2003	41,226	4,081	$2,000	$8,162,755
2004	41,993	4,157	$2,500	$10,393,227
2005	42,774	4,235	$3,000	$12,703,850
2006	43,569	4,313	$3,000	$12,940,141

The total General Fund revenue loss from the long term care needs credit is as follows:

	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
Community	$65,533,045	$75,710,441	$88,734,047	$99,347,417	$104,213,659
Nursing Home	$6,010,275	$8,162,755	$10,393,227	$12,703,850	$12,940,141
Total	$71,543,320	$83,873,196	$99,127,274	$112,051,267	$117,153,800

Expenditures

SB 1382 has no direct impact on the budget of the Department of Revenue, but a recent unpublished analysis by the Department of Revenue may prompt the future addition of audit staff for the existing long term care insurance credit and the proposed new credit. According to the Department of Revenue, the long-term care insurance credit was claimed by 19,840 taxpayers who electronically filed their 2001 returns. The Department identified 3,675 returns that claimed the maximum $350 credit and disallowed 2,138 because they were claimed in error. In most cases, the taxpayers claimed the long-term care insurance credit for health insurance premium payments. The number of credits disallowed equals an error rate of 58% for the maximum long-term care insurance credit for the 2001 tax year. The Department does not have the resources to audit all returns with this credit nor will the Department have the resources to audit all returns claiming the long-term care needs credit.

SOURCES OF DATA

Tax Research Division – Department of Revenue; J.K.Lasser's Your Income Tax 2002; "Description of Revenue Provisions Contained in the President's Fiscal Year 2001 Budget Proposal" by Congressional Joint Committee on Taxation; "1999 Long Term Care Insurance Experience Reports – Form C," National Association of Insurance Commissioners, Dr. Marc Cohen of LifePlans, Inc.; "An Analysis of the President's Proposed Long Term Care Tax Credit" for the Alzheimer's Association in 1999, the Lewin Group; US Census Bureau

TECHNICAL CONSIDERATIONS

The long-term care needs tax credit proposal is very similar to one in President Clinton's Fiscal Year 2001 Budget Proposal. However, that tax credit proposal required the taxpayer to include with the tax return (1) the taxpayer identification number for the individual with long term care needs and (2) a physician identification number for the certifying physician (such as the Unique Physician Identification Number required for Medicare billing). Without this information, the Department of Revenue cannot verify the validity of the tax credit claim.

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