

Fiscal Note & Local Impact Statement

123rd General Assembly of Ohio

BILL: **H.B. 33** DATE: **February 16, 1999**
STATUS: **As Introduced** SPONSOR: **Rep. Jolivette**
LOCAL IMPACT STATEMENT REQUIRED: **Yes**
CONTENTS: **Creates an Ohio Income Tax Deduction For Long-Term Care Insurance Premiums**

State Fiscal Highlights

STATE FUND	FY 1999	FY 2000	FUTURE YEARS
General Revenue Fund			
Revenues	- 0 -	Loss of \$12.7 million	Loss of \$14.2 million in FY 2001, increasing thereafter
Expenditures	- 0 -	- 0 -	- 0 -

- The proposed deduction will benefit an estimated 212,000 long-term care (LTC) insurance policyholders in CY 1999, and an estimated 242,000 in CY 2000.
- The proposed deduction will confer a tax advantage on an estimated \$298 million in LTC insurance premiums in CY 1999, and an estimated \$340 million in CY 2000.
- The total state tax loss is estimated at \$14.2 million in FY 2000, and \$16.2 million in FY 2001. The GRF will bear \$12.7 million and \$14.2 million of that loss, respectively.
- Expert opinion is divided on how much the state can expect to see in Medicaid savings if the private insurance market is stimulated through federal and state tax incentives.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 1999	FY 2000	FUTURE YEARS
Library and Local Government Support Fund (LLGSF)			
Revenues	- 0 -	Loss of \$809,000	Loss of \$923,000 in FY 2001, increasing thereafter
Expenditures	- 0 -	- 0 -	- 0 -
Local Government Fund (LGF) and Local Government Revenue Assistance Fund (LGRAF)			
Revenues	- 0 -	Loss of \$682,000	Loss of \$777,000 in FY 2001, increasing thereafter
Expenditures	- 0 -	- 0 -	- 0 -

- The proposed deduction leads to income tax losses for the three local government funds of approximately \$1.5 million in FY 2000, and \$1.7 million in FY 2001.



Detailed Fiscal Analysis

The bill allows a deduction for long-term care insurance premiums, to the extent that such premiums are included in federal adjusted gross income (FAGI). LBO estimates that this deduction will lead to an annual revenue loss of \$14.2 million in FY 2000 and \$16.2 million in FY 2001. The estimating process involves several steps.

The National Market – Growth in Policies

Long-term care insurance is a young and relatively small market, but one that is growing rapidly. Based on information from the Health Insurance Association of America (HIAA), by the end of CY 1996, total policies sold were 4.96 million, up from only 200,000 in 1986.¹ Growth in policy sales is in double digits annually. Percentage growth was slowing through 1994, but seems to have begun accelerating slightly in 1995 and 1996. Over the last 10 years, an average of 450,000 to 500,000 new policies have been sold each year.²

Policy sales may accelerate even more after the federal tax changes made by the Health Insurance Portability and Accessibility Act (HIPAA) of 1996. The federal act generally gave long-term care insurance the same tax status as accident and health insurance. Specifically, the act made the following clarifications to the tax treatment of long-term health insurance:

- (i) benefits from a qualified long-term care insurance policy are excluded from gross income;
- (ii) premiums from a long-term care insurance policy can be deducted as a medical expense, like regular health insurance and out-of-pocket expenses, as long as medical expenses exceed 7.5% of FAGI. (However, there are age-based limitations on the amount of premiums that can be used in calculating the deduction. For example, individuals aged 51 to 60 are limited to including up to \$750 in annual premiums.)
- (iii) Employer contributions toward an employee's long-term care policy can be deducted as a business expense.

It will be awhile before survey data is available so that analysts can judge the impact of the federal tax benefits. LBO's forecast of the number of national policies sold in CY 1997-2000, along with recent history, are shown in the table below.

¹ "HIAA Statement: The Role of Private Long-Term Care Insurance in Financing Long-Term Care and the Importance of Offering Long-Term Care Insurance to All Federal Employees," Testimony by David Brenerman before the Subcommittee on Civil Service of the Committee on Government Reform and Oversight, U.S. Congress.

² Despite the growth in the private LTC market, in CY 1995 less than 1 percent of expenditures for long-term care for the elderly were financed by private LTC insurance.

But of the policies sold, how many are still in effect? The cumulative number of policies sold is a misleading figure because it does not take into account the fact that many people have let their policies lapse, some policies have dropped one policy in exchange for another, and some policyholders have died. The HIAA does not collect information on the number of policies in force. A survey of insurance companies by the General Accounting

	Year	Cumulative	Annual Change	% Change
	1986	200,000		
	1987	815,000	615,000	307.5%
	1988	1,130,000	315,000	38.7%
	1989	1,550,000	420,000	37.2%
	1990	1,930,000	380,000	24.5%
	1991	2,430,000	500,000	25.9%
	1992	2,930,000	500,000	20.6%
	1993	3,417,000	487,000	16.6%
	1994	3,837,000	420,000	12.3%
	1995	4,351,000	514,000	13.4%
	1996	4,960,000	609,000	14.0%
lbo estimate	1997	5,654,400	694,400	14.0%
lbo estimate	1998	6,446,016	791,616	14.0%
lbo estimate	1999	7,348,458	902,442	14.0%
lbo estimate	2000	8,377,242	1,028,784	14.0%

Source: Health Insurance Association of America (HIAA) LTC Market Survey

Office (GAO) found that the companies expected 20% of LTC insurance policies purchased to lapse in the first year, and 50% were expected to lapse within five years.³ If this holds true for the market generally, then the number of policies in effect would be as shown in the following table.

Calendar Year	Cumulative Policies Sold	Annual Policies Sold	Policies In Effect	% Change
1986	200,000		200,000	
1987	815,000	615,000	775,000	287.5%
1988	1,130,000	315,000	952,000	22.8%
1989	1,550,000	420,000	1,201,750	26.2%
1990	1,930,000	380,000	1,389,375	15.6%
1991	2,430,000	500,000	1,665,625	19.9%
1992	2,930,000	500,000	1,953,500	17.3%
1993	3,417,000	487,000	2,205,500	12.9%
1994	3,837,000	420,000	2,387,100	8.2%
1995	4,351,000	514,000	2,669,050	11.8%
1996	4,960,000	609,000	3,038,225	13.8%
1997	5,654,400	694,400	3,465,700	14.1%
1998	6,446,016	791,616	3,957,036	14.2%
1999	7,348,458	902,442	4,512,770	14.0%
2000	8,377,242	1,028,784	5,144,568	14.0%

Source: LBO Estimates Based on HIAA and GAO Data

³ See *Health Care Reform: Supplemental and Long-Term Care Insurance*, (GAO/T-HRD-94-58), Nov. 9, 1993.

The National Market – Types of Policies, Premiums

The bill allows a deduction for LTC insurance premiums, to the extent that they are included in FAGI. Some LTC insurance premiums will not be included in FAGI. The HIAA estimates that 87% of policies are sold to individuals, through the individual and group-association markets (80%), and through life insurance riders (7%). The other 13% of policies are sold through the employer-sponsored insurance market.⁴ As stated above, HIPAA makes it clear that employer-sponsored LTC insurance benefits are excluded from FAGI, so they are not covered under this bill. The table below has some HIAA premium data for 1996.

Average Annual Premiums for Leading Individual and Group Association Long-Term Care Sellers in 1996

AGE	Base	With 5% Compounded Inflation Protection (IP)	With a Nonforfeiture Benefit (NFB)	W/ IP & NFB
40	\$250	\$590	\$340	\$800
50	\$365	\$800	\$520	\$1,200
65	\$1,000	\$1,830	\$1,320	\$2,450
79	\$4,000	\$5,600	\$5,200	\$7,500

(NOTE: These are preliminary estimates for premiums of 1996 leading sellers. Premiums are generally for a \$100/\$50 nursing home/home health coverage, 4 years coverage, and 20-day elimination period.)

SOURCE: HIAA LTC Market Survey, 1997.

The HIAA reports that premiums for individual and group association policies sold by reporting companies were \$616.5 million nationally in CY 1995. From this figure, LBO estimates that total premium volume for all individual and group association policies, and all life insurance rider policies, was about \$716.5 million. There were 514,000 policies sold that year, with an estimated 451,000 being individual, group association, or life insurance rider. This puts the average annual premium at about \$1,589.

Based on LBO’s estimate of policies in effect in CY 1999 and CY 2000, the amount of deductible premiums for the United States is \$6,339.5 million in CY 1999 and \$7,227.1 million in CY 2000.

⁴ Coronel S. and Kitchman M. (1997). *Long-Term Care Insurance in 1995*. Washington, D.C.: Health Insurance Association of America.

LBO Estimate: LTC Insurance Premiums in FAGI, CY 1999-2000				
Calendar Year	Policies in Effect	Individual, Group, and Life-Rider	Average Annual Premium	Total Premiums in FAGI
1999	4,512,770	3,962,212	\$ 1,600	\$6,339,539,352
2000	5,144,568	4,516,931	\$ 1,600	\$7,227,089,612

The Ohio Market

HIAA survey data indicates that 4.7% of all LTC insurance policies have been sold in Ohio. Ohio ranks sixth among all states in percentage of policies sold. HIAA has also calculated the LTC insurance “penetration rate,” defined as policies sold in each state divided by the number of persons aged 65 or older living in that state. Ohio ranks in the middle of the pack, among 10 states that have penetration rates between 7% and 9%.

Based on the national calculations made earlier, Ohio’s figures for policies sold, policies in effect, individual, group, and life rider policies in effect, and premiums included in FAGI are shown in the next table. LBO estimates that Ohioans would have \$298.0 million in deductible premiums in CY 1999 and \$339.7 million in deductible premiums in CY 2000.

Ohio Tax Impacts

Most sales of long-term care insurance are to the elderly. Recognizing that fact, HIAA has collected survey data on purchasers age 55 and older. LBO has taken the HIAA data on annual incomes for these purchasers and translated them (by an admittedly rough procedure) into Ohio Taxable Income (OTI) brackets.⁵ Based on this breakdown, we have attributed a marginal tax rate to each group of purchasers, and estimated the annual tax loss. The total tax revenue loss is estimated to be \$14.2 million in FY 2000, and \$16.2 million in FY 2001.

Estimated Revenue Loss, CY 1999 - 2000 [FY 2000 - 2001]				
Calendar Year	OTI Amount	estimated avg. marginal tax rate	Premiums in FAGI	Estimated Revenue Loss
1999	\$0-\$20,000	3.500%	\$ 62,571,253	\$ 2,189,994
	\$20,000-\$40,000	4.457%	\$ 137,060,841	\$ 6,108,802
	\$40,000 and over	6.000%	\$ 98,326,255	\$ 5,899,575
	<u>Total</u>		\$ 297,958,350	\$ 14,198,371
2000	\$0-\$20,000	3.500%	\$ 71,331,374	\$ 2,496,598
	\$20,000-\$40,000	4.457%	\$ 156,249,677	\$ 6,964,048
	\$40,000 and over	6.000%	\$ 112,092,160	\$ 6,725,530
	<u>Total</u>		\$ 339,673,212	\$ 16,186,176

⁵ The survey income data for purchasers is from LifePlans, Inc. (1995). *Who Buys Long-Term Care Insurance: 1994-95 Profiles and Innovations in a Dynamic Market*. Washington, DC: Health Insurance Association of America.

The tax revenue loss will be divided between the state GRF and the three local government funds, as follows:

Estimated Revenue Loss, CY 1999 - 2000 [FY 2000 - 2001], by Fund								
Fiscal Year		GRF		LLGSF		LGF		LGRAF
2000	\$	12,707,542	\$	809,307	\$	596,332	\$	85,190
2001	\$	14,486,627	\$	922,612	\$	679,819	\$	97,117

The state GRF receives 89.5% of state income tax revenue, while the Library and Local Government Support Fund (LLGSF) receives 5.7%, the Local Government Fund (LGF) receives 4.2%, and the Local Government Revenue Assistance Fund (LGRAF) receives 0.6%.

Risks to the Estimates

It should be clear by now that the estimated tax revenue losses are built on data from 1996, in a market that is changing and growing rapidly. It is possible that:

- Policies bought will increase faster than LBO has assumed due to HIPAA.
- Other federal tax benefits will be implemented, which will cause policy purchases to increase faster.
- The tax incentive created in this bill will induce some purchases over and above what is assumed in the estimates.
- Average annual premiums will exceed the \$1,600 estimate here. Average annual premiums rose fairly sharply from 1991 to 1994, but HIAA reports that premiums for leading sellers declined somewhat in 1995 and 1996. For that reason LBO held estimated average premiums steady.

LBO is still hoping to obtain data on estimated or actual revenue impacts from the other 9 states – Alabama, California, Iowa, Maine, Minnesota, Montana, North Dakota, New York, and Wisconsin – that have tax incentives for LTC insurance.

The Impact on Medicaid Spending

Part of the rationale for offering tax incentives for LTC insurance is to avoid future Medicaid costs. LBO does not have the resources to independently estimate future Medicaid savings by stimulating the private LTC insurance market, but here we report the estimates of some other researchers. The estimates below are not the result of a state income tax incentive, but of increased insurance purchases due to a number of factors such as federal tax incentives, state tax incentives, improved consumer education, etc.

To get an idea of the different results one can get in terms of Medicaid savings, based on the different assumptions one uses in simulation, one can look at the work of the American Council of Life Insurance (ACLI) and of economists at the Brookings Institution. The ACLI begins with the assumption that all individuals 35 years of age and older in the year 2000 who can afford an LTC insurance policy actually purchase one (affordability is defined as spending up

to 2% of income for ages 35-44, up to 3% of income for ages 45-54, up to 4% of income for ages 55-59, and up to 5% of income over age 60).⁶ The ACLI then compared a simulation of national Medicaid expenditure in CY 2030 under current long-term care trends with a simulation assuming this increased purchase of LTC insurance. By CY 2030, national Medicaid expenditure under the increased insurance assumption was \$106 billion, a savings of \$28 billion, or 21%, from the current trends simulation.

In contrast, the Brookings economists simulated four different private long-term care insurance options using the Brookings-ICF Long-Term Care Financing Model. Their simulations showed that the market penetration and ability to finance long-term care of private insurance aimed at the elderly is likely to remain extremely limited. Even under the assumption that the elderly with only minimal assets will spend a substantial portion of their income for policies, only one in five elderly people could have a policy in 2018. Because of limited market penetration, private insurance bought by the elderly is unlikely to substantially ease the burden of out-of-pocket long-term care costs. Moreover, because private insurance is bought mostly by upper-middle and upper-income elderly with substantial assets, it will have little impact on Medicaid nursing home spending. For policies sold to the elderly, the projected Medicaid nursing home savings were only 2-4 percent by CY 2018.⁷

The Brookings economists did find substantial Medicaid nursing home savings – on the order of 32% by CY 2018 – in what they described as an optimistic simulation of employer-sponsored LTC insurance. The employer-sponsored LTCI simulation assumed the following:

- All persons purchase insurance policies that cover two or four years of nursing home and home care and pay an initial indemnity value of \$60 per day for nursing home care and \$30 per visit for home care in 1986. Indemnity values increase by 5.5% per year on a compound basis. Premiums for nonelderly persons increase by 5.5% per year until age 65 and are then level. All nondisabled person who meet affordability criteria buy as much as insurance as they can afford.
- Persons as young as age 40 purchase group or individual long-term care insurance policies. Nonelderly purchase policies if premiums are between 2% and 4% of income (depending on age). Elderly persons purchase policies if they can afford them for 5% or less of income and if they have \$10,000 or more in nonhousing assets.

Based on this research, stimulating the private LTC insurance market for individuals could result in Medicaid savings of anywhere from 2-4% in CY 2018 to 21% in CY 2030. There is undoubtedly other research of which LBO is not yet aware with different estimates of potential Medicaid savings.

LBO staff: , Frederick Church, Senior Economist
H:\Fn123\HB0033IN.DOC

⁶ Janemarie Mulvey and Barbara Stucki, *Who Will Pay for the Baby Boomers' Long-Term Care Needs?*, American Council of Life Insurance, April 1998.

⁷ These results are summarized in "Can Private Insurance Solve the Long-Term Care Problems of the Baby Boom Generation?," The Urban Institute, Testimony presented at "The Cash Crunch: The Financial Challenge of Long-Term Care for the Baby Boom Generation," a hearing held by the Special Committee on Aging, United States Senate, Washington, D.C., March 9, 1998.