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SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 584 HD 2 SD 1
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

The purpose of this bill is to provide a refundable net income tax credit to Hawaii residents for the purchase of long-term care insurance.

The Senate Committee on Human Services & Public Housing amended the measure by inserting a current effective date for taxable years beginning after December 31, 2008.

The Department of Taxation **strongly supports** this bill

I. THE NEED FOR LONG-TERM CARE INSURANCE CONTRACTS.

The future of long-term care for Hawaii's senior and adult disabled population is one of the most critical health issues facing Hawaii in the twenty-first century. Persons sixty years of age and older presently account for almost one-fifth of the adult population in the State. By 2020, they will constitute more than one-fourth of Hawaii's adult population.

The rapid growth of the elderly and disabled populations will result in extraordinary demands on the delivery of long-term care services. While the majority of persons receiving long-term care are older adults, entire families are affected by the psychological, financial, and social costs of long-term care provided to those who are limited in the activities of daily living. As of 2003, the statewide average annual cost of a room in a skilled nursing facility was $105,028 for a private room and $95,597 for a semi-private room.

II. INDIVIDUAL LONG-TERM CARE TAX CREDIT

This bill creates a refundable long-term care tax credit for individual taxpayers. This tax credit is based upon a taxpayer's filing status and adjusted gross income. The credit is available to married taxpayers who file a joint return and who have adjusted gross incomes of $100,000 or less; for all other individual taxpayers who file a return, including married couples filing a separate return, the credit is available for those with adjusted gross incomes of $50,000 or less.

Subject to the cap on the total amount of the credit, the taxpayer may claim the tax credit for qualified long-term care insurance that the taxpayer purchases for the taxpayer, a spouse, a son or daughter, a stepson or stepdaughter, a father or mother, a stepfather or stepmother, or a dependent (as defined in tax law) living in the taxpayer's home.

This individual long-term care tax credit accomplishes the following:

- Encourages Hawaii residents to purchase private long-term care insurance so that they will have more long-term care options when they require long-term care, and
- Averts the impending Medicaid crisis with the aging of a substantial segment of Hawaii's residents.
- Helps Hawaii residents with lower incomes afford the cost of long-term care insurance; and
- Provides a reasonable financial incentive for Hawaii residents with to purchase their own private long-term care insurance.

According to data obtained by the Department's Tax Research and Planning Office, the average long-term care insurance premium paid by married Hawaii residents totals $2,500 annually. The average long-term care premium paid by individual Hawaii residents totals $1,250.[1] Given these premium cost averages, this legislation will assist in minimizing the financial impact of purchasing privatized insurance, as well as encouraging persons to purchase this much-needed insurance coverage for the aging.

III. REVENUE IMPACT

This legislation will result in a revenue loss to the general fund of approximately $6 million per year for FY 2010 and thereafter. The DCCA data indicated that the estimated long-term care premiums were about $39.1 million in CY2003. Average premium per person is assumed to be about $2,500 per year and the number of insured persons is 15,640 from very preliminary discussion with DCCA. Based on AGI class, the participation rate for single, head of household, and qualifying widower is assumed to be 30% of the DCCA estimated number of insured persons; joint, 60%; married filing separate, 10%; resulting in a total of 6,506 qualifying taxpayers. The Department also assumed that 50% of qualifying taxpayers purchased long-term care policies through their employers and paid 50% of the premium.

[1] Based upon aggregate data received from the Insurance Commissioner's Office in the Department of Commerce and Consumer Affairs.

TESTIMONY OF THE AMERICAN COUNCIL OF LIFE INSURERS
IN SUPPORT OF H. B. 584, HD 2, SD 1, RELATING TO TAXATION

March 18, 2008

Senator Carol Fukunaga, Chair
Committee on Economic Development and Taxation
State Senate
Hawaii State Capital, Conference Room 016
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Fukunaga and Committee Members:

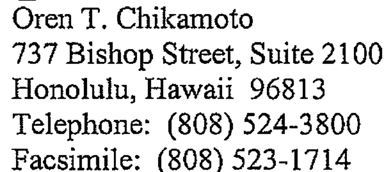
Thank you for the opportunity to testify in support of House Bill 584, HD 2, SD 1, relating to taxation.

Our firm represents the American Council of Life Insurers ("ACLI"), a national trade association whose three hundred fifty-three (353) member companies account for 93% of the life insurance premiums and 94% of the annuity considerations in the United States among legal reserve life insurance companies. ACLI member company assets account for 93% of legal reserve company total assets. Two hundred sixty-one (261) ACLI member companies currently do business in the State of Hawaii.

ACLI supports House Bill 584, HD 2, SD 1, which provides an income tax credit to qualified resident individual taxpayers in an amount equal to the lesser of $2,500 or 50% of the cost of the long-term care insurance premium. Married couples filing jointly may qualify for the tax credit only if their adjusted gross income is $100,000 or less; individual taxpayers qualify only if their adjusted gross income is $50,000 or less.

ACLI generally believes that as a matter of public policy the State of Hawaii should encourage families to provide for their own financial well-being. If a family is unable to support its long-term care needs, the State will need to spend its scare resources for that purpose.

CHAR HAMILTON
CAMPBELL & YOSHIDA
Attorneys At Law, A Law Corporation



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Senate Committee on Economic Development & Taxation
Senator Carol Fukunaga, Chair

Date of Hearing: **March 18, 2008**
Time: **1:15 PM**

RE: HB 584, HD 2, SD 1 -- Relating to Taxation

Chair Fukunaga and members of the Committee, the NAIFA (National Association of Insurance and Financial Advisors) Hawaii, an organization made up of insurance and financial advisors across Hawaii **supports HB 584, HD 2, SD 1,** in providing our citizens with an incentive to purchase LTC (long term care) insurance.

This measure will allow Hawaii residents to qualify for a LTC insurance premium tax credit. The tax credit will apply to married couples filing jointly with an adjusted gross income of up to $100,000 and up to $50,000 for an individual taxpayer. The tax credit shall be the **lesser** of $2,500.00 for a joint return or 50% of the LTC insurance premium for an individual for the taxable year which payments are made.

The tax credit for LTC insurance premium payments will allow our residents to use this tax incentive **either as a tax credit or a tax deduction**. The tax deduction is allowed under the Internal Revenue Code and Hawaii tax law for medical services and premium payments, provided that these expenses exceed 7.5% of the taxpayer's adjusted gross income.

Section 2 of the bill on page 6, lines 4 to 13, regarding the tax credit to the son/daughter, stepson/stepdaughter, father/mother, stepfather/stepmother **may not track** as it relates to page 4, lines 9 to 16, "Each individual taxpayer who files an individual income tax return for a taxable year, and who is not claimed or is not otherwise eligible to be claimed as a dependent by another taxpayer of Hawaii state individual income tax purposes…"

We question the taxpayer who pays the LTC insurance premium for **non-dependent relatives** as stated above. If the non-dependent relative is also paying part of the premium on the same policy, that non-dependent relative will also qualify for the tax credit. We suggest that the language be specific in that these non-dependent relatives cannot be claimed by the taxpayer if the non-dependent is also taking the credit on the same policy.

Medicaid began as a safety net for the less fortunate but over the past 30 years loopholes have "saved" family assets through "Medicaid planning" that we see advertised. By purchasing LTC insurance policies, the original Medicaid "safety net" can serve those truly in need. The burden on state and federal governments continues to grow and we need to address this complex problem before the baby boomers wind their way through their golden years.

We support a tax credit for LTC insurance premiums for Hawaii's citizens. We realize the fiscal constraints on the general fund but urge that this LTC insurance premium tax credit measure continue to move forward.

Thank you for allowing us to share our views.

Cynthia Hayakawa
Executive Director

TO: Senator Carol Fukunaga, Chair
Senator Will Espero, Vice Chair
Committee on Economic Development and Taxation

FROM: David Nixon, Associate Professor
Social Science Public Policy Center
University of Hawaii at Manoa

RE: HB 584, HD2, SD1 providing a long term care insurance tax credit
scheduled for testimony 3.18.2008 at 1:15pm, Conference Room 224

Thank you for the opportunity to testify about HB584, a bill to provide a long term care insurance tax credit.

The Social Science Public Policy Center exists to provide non-political research-based contributions to the public policy debate. As HB584 rightly notes, long term care is a critical public policy challenge for Hawaii in the coming decades. As a result, aging policies are an important component of the research agenda for the Policy Center. Last year, we conducted research about long term care insurance tax credits that is specifically relevant to the provisions of HB584.

One of the primary reasons for the failure of every other state tax incentive for long term care insurance is that the subsidies provided by those states are paltry in magnitude, and insufficient to induce new purchases of this somewhat expensive insurance product. As the right hand column of Table A1 makes clear (next two pages, from our full paper), states are providing subsidies in the range of 3-25%. Our research (a Policy Brief is attached at the end of this testimony) shows unequivocally that the state income tax subsidies in that range have not induced more widespread private purchase of long term care insurance there.

HB584 HD2 SD1 provides a level of subsidy that is **much more generous** than has been provided by any other state, and it therefore presents the **potential for successfully encouraging more private purchase of long term care insurance**. Because a 50% subsidy has never been attempted in any other state, the research we conducted does not speak to whether HB584 HD2 will be successful. I can tell you only, and without hesitation that, **if the subsidy level is reduced in subsequent legislative negotiations, it raises the risk that the bill will fail to achieve its policy goals**. Specifically, a Hawaii tax credit of below 25% is virtually certain to be a failure, based on the clear evidence from other states. Please keep that in mind as budget planning proceeds. Furthermore, **there is some significant risk that even the 50% credit will be insufficient to induce NEW purchases of long term care insurance**. The committee might therefore consider amending the legislation, to sunset the credit after two or three years. A sunset provision would allow the credit to lapse without specific legislation, unless clear evidence can be marshaled for its success. I can assure you that if HB584 passes with a 50% credit, the Public Policy Center will be carefully scrutinizing its success or failure.

Thank you for your consideration.

Table A1: State Tax Incentives for Long-Term Care Insurance

(from D. Nixon, 2007)

State	Provisions[1]	State Subsidy for $1000 long-term care insurance premium[2]	
Alabama	an individual may deduct all premium costs from state adjusted gross income	$50	(5%)
Colorado	an individual may take a tax credit of 25% of premium, or $150, whichever is less	$150	(15%)
Indiana	an individual may deduct all premium costs from state adjusted gross income	$34	(3.4%)
Iowa	an individual may deduct all premium costs from state adjusted gross income that are not already deducted on their federal return	$79.20[3]	(7.9%)
Kentucky	an individual may deduct all premium costs from state adjusted gross income	$60	(6%)
Maine	an individual may deduct all premium costs from state adjusted gross income	$85	(8.5%)
	an employer may take a tax credit of 20% of premium, or $100 per employee, whichever is less	$100	(10%)
Maryland	an employer may take a tax credit of 20% of premium, or $100 per employee, whichever is less	$100	(10%)
Minnesota	an individual may take a tax credit of 25% of premium, or $100, whichever is less, and only for costs not already deducted on their federal return	$100	(10%)
Missouri	an individual may deduct 50% of premium costs from state	$30	(3%)

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[1] adapted from Grooters, 1999, and updated to 2002, the most recent year of available insurance sales data..

[2] data on state tax rates, necessary for calculating the value of a state tax deduction, comes from salary.com [http://swz.salary.com/salarywizard/layouthtmls/swzl_statetaxrate_AL.html]. Because taxes paid to state governments are deductible on federal tax returns, the value of the tax subsidy for any individual is technically reduced by the percentage of their federal tax rate (Claveria 1987).

[3] based on income tax rate for an individual earning between $37,261 and $55,890 (taxed at 7.92%). If an individual earned more than $55,890, their tax rate (the top rate in the state) would be 8.98%, translating into an effective tax subsidy of $89.80 on every one thousand dollars of long-term care insurance. The next lowest rate (for earnings between $24,841 and $37,260) is 6.8%.

	adjusted gross income		
Montana	an individual may deduct all premium costs from state adjusted gross income	$90[4]	**(9%)**
North Carolina	an individual may take a tax credit of 15% of premium	$150	**(15%)**
North Dakota	an individual may take a tax credit of 25% of premium	$250	**(25%)**
Ohio	an individual may deduct all premium costs from state adjusted gross income	$52.01[5]	**(5.2%)**
Utah	an individual may deduct all premium costs from state adjusted gross income	$70	**(7%)**
West Virginia	an individual may deduct all premium costs from state adjusted gross income	$60[6]	**(6%)**
Wisconsin	an individual may deduct all premium costs from state adjusted gross income that are not already deducted on their federal return	$65	**(6.5%)**

[4] based on income tax rate for an individual earning between $32,100 and $40,000 (taxed at 9.0%). The top tax rate (10.0%) applies to those earning more than $40,000, and would translate into an effective tax subsidy of $100 for every $1000 of long-term care insurance. The next lowest rate (for earnings between $22,900 and $32,100) is 8.0%.

[5] based on income tax rate for an individual earning between $40,000 and $80,000 (taxed at 5.201%). The top tax rate (7.5%) applies to those earning more than $200,000, and would translate into an effective tax subsidy of $75 for every $1000 of long-term care insurance. The next lowest rate (for earnings between $20,000 and $40,000) is 4.457%.

[6] based on income tax rate for an individual earning between $40,000 and $60,000 (taxed at 6%). If an individual earned more than $60,000, their tax rate (the top rate in the state) would be 6.5%, translating into an effective tax subsidy of $65 on every one thousand dollars of long-term care insurance. The next lowest rate (for earnings between $25,000 and $40,000) is 4.5%.

COLLEGE OF SOCIAL SCIENCES
public policy center
UNIVERSITY OF HAWAI'I AT MĀNOA

POLICY BRIEF number 001, November 2006

State Programs to Encourage Long Term Care Insurance

This policy brief summarizes a detailed report available on our website about the impacts of state incentive programs on an individual's decision to purchase long term care insurance.

State governments across the nation are becoming acutely aware of the increasing costs of medical care for the elderly and disabled. Many observers see a significant financial crisis looming. As the baby boom generation ages, and Medicaid costs grow, states will be spending more and more of their budgets to cover these costs. Hawaii's share of Medicaid expenditures will more than double between now and 2020. Encouraging individuals to purchase private long term care insurance has been seen as one solution to this crisis. If individuals purchase long term care insurance in the private market, the state's Medicaid expenditures may not grow as quickly.

Our report examines two efforts by state governments to encourage people to buy long term care insurance for themselves: (a) tax incentives for either individuals or employers who buy long term care insurance, and (b) an experimental program sponsored by state governments and the private sector insurers and implemented in four states, called the Long Term Care Insurance Partnership. The Partnership programs encourage long term care insurance sales by allowing people who buy long term care insurance for themselves to avoid the asset rules for Medicaid eligibility, if they exhaust their private insurance benefits. The insurance policies eligible for the Partnership provide extensive long term care benefits, so the program potentially encourages more long term care insurance sales without exposing the state Medicaid program to additional claimants. Recent federal legislation allows any state to establish a Partnership program patterned on the pilot programs through a Medicaid waiver request.

Key Findings

- State tax incentives for long term care insurance premiums of a magnitude offered in about a dozen U.S. states have **not** induced additional sales of insurance beyond what could be expected without the incentives.
- The Long Term Care Partnership program implemented in four states has similarly failed to induce additional sales of private insurance for long term care beyond what could have been predicted from demographic factors alone.

We examined the number of private sector long term care insurance policies sold in each state, as reported in 2004 by America's Health Insurance Plans (formerly the Health Insurance Association of America). There is significant variation across the states in the size of the local long term care insurance market. In Alabama, less than 2% of the over-50 population is insured for long term care with a private policy, while over 15% of the over-50 population in South Dakota is so insured.

Policy analysts and policy makers hope to move those market figures above 50%, in order to avoid the huge Medicaid claims that will impact governments in the coming decades.

Results of a statistical model to predict sales of long term care insurance policies demonstrates that income, expected health, and family support factors are significant determinants of the size of the long term care insurance market in each state. When a state's population has higher income, a greater expectation of experiencing old-age disabilities, and lower incidence of living with their children in old age, sales of long term care insurance are significantly higher.

Our findings demonstrate that the availability of one's children as potential long term care givers has a very strong influence on one's decision to purchase long term care insurance. Family support has a strong direct effect on aggregate long term care insurance sales. A more integrated family structure also reduces the degree to which older people incorporate health expectations into their long term care insurance purchase decisions.

For example, in state populations with limited availability of children as caregivers, such as midwestern rural states, expectations about one's health in old age are a significant factor in one's decision to purchase long term care insurance. But in states where the older population more frequently lives with its children, such as Hawaii, expectations about one's health in old age are not significantly related to long term care insurance sales.

We conclude by pointing out that the subsidies provided in the state incentive plans we examined are very limited, relative to the typical cost of premiums. Even though a 50 year old might expect to pay $2000 a year or more for long term care insurance, existing state subsidies would defray no more than $500 of that cost, and more typically about $200. It turns out incentives in this range are insufficient, by themselves, to prompt anyone to buy a long term care insurance policy. Several tax plans considered by the Hawaii legislature in recent years have been within this range of subsidy.

While state subsidies are meager for individuals, the sum total of such incentives are costly to the states. Because they are not prompting new purchases of insurance, those tax dollars are being wasted on people who would have purchased long term insurance anyway. Unless states enact substantially more generous subsidies *and* focus the subsidies on more price-conscious potential buyers of insurance, the programs are counterproductive. They draw resources away from state coffers that could be better spent preparing for the approaching long term care crisis.

About the Author

David C. Nixon is a Visiting Associate Professor of Public Policy at University of Hawaii and Associate Professor of Political Science at Georgia State University. He earned a Ph.D. in political science from Washington University in St. Louis, and specializes in policymaking by appointed officials.

A copy of this Policy Brief or the full Report on which it is based can be found at www.publicpolicycenter.hawaii.edu/reports.html

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Credit for long-term care insurance premiums

BILL NUMBER: HB 584, SD-1

INTRODUCED BY: Senate Committee on Human Services and Public Housing

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow taxpayers to claim a tax credit for the amount paid for a long-term care insurance premium. The maximum amount of credit for an individual taxpayer or a husband and wife filing jointly shall be the lesser of: (1) $2,500; or (2) 50% of the cost of any long-term care insurance premium payments provided that a husband and wife filing separately for which a joint return may be filed shall only be entitled to the amount of credit if they had filed jointly. Stipulates that the tax credit shall be available to taxpayers with adjusted gross income of: (1) $100,000 or less for a married couple filing jointly; or (2) $50,000 or less for individual taxpayers.

Delineates what premium payments shall be eligible for the credit and specifies persons, besides the taxpayer and immediate dependents, whose premiums may be eligible for the credit. Credits properly claimed and in excess of tax liability shall be refunded to the taxpayer.

If the taxpayer takes a deduction under IRC section 213 (with respect to medical, dental, etc., expenses) no tax credit may be claimed for that portion of the cost for which the deduction was taken. Claims for the credit must be filed within twelve months of the close of the taxable year or be waived if not filed on time.

EFFECTIVE DATE: July 1, 2008; applicable to tax years beginning after December 31, 2008

STAFF COMMENTS: This measure provides an incentive to taxpayers to purchase long-term care (LTC) insurance premiums by allowing taxpayers to claim a credit for amounts paid for such insurance. To the extent that this is an alternative to a state-run, long-term care insurance program, it is a proposal that deserves serious consideration. The question is whether or not individuals will plan ahead for their needs in time to make such insurance reasonable and affordable. Encouraging taxpayers to acquire LTC insurance now will insure that the state will not be burdened with supporting persons as the need arises.

The question now is whether or not the state can afford an incentive given all the other competing interests. It should be noted that, as drafted, it would appear that the credit limits are per return. Thus, the 50% or $2,500, whichever is less, applies to all insurance paid by the taxpayer filing that return. Thus, if a couple bought policies for themselves and one of the spouse's parents, the maximum amount that could be claimed would be $2,500 even though the premiums for all three policies total more than $5,000. On the other end, with an unknown impact, the legislature may want to take it slow and phase-in the credit to assess the impact that this credit will have on the state treasury.

It should be noted that the proposed measure limits the availability of the credit to those joint filers with $100,000 or less and single filers with $50,000 or less of adjusted gross income. If the intent is to get as

many people to take out private, long-term care policies, then the credit should not be limited to only those with a certain amount of income. A couple at the high end of the income scale may have the resources to take out policies for themselves as well as for an aging parent. They should be provided the same incentive to do so as it will save the state in the long run from having to provide long-term care for any one of them. Consideration might be given to an inversely graduated amount of credit such that the amount of the credit gets smaller as income grows larger.

That said, there are two provisions of the bill which are not clear. First, is the amount of the credit equal to the lesser of 50% of the long-term care insurance premiums paid or $2,500? Or does the bill mean to say the credit is 50%of the long-term care insurance premium paid up to a maximum of $2,500 per return? If it is the latter, then the bill should state so. The other is that it is unclear whether or not the credit is refundable. It seems to imply that it is refundable by stating that no refunds of amounts less than one dollar shall be made, but other than that, it does not specifically provide that the credit is refundable or non-refundable. If the latter is the case, then there is no provision directing that any excess credit can be applied to subsequent tax years liability until exhausted.

Given that many advocates of a previously proposed state run long-term care insurance system noted that to do nothing about providing for such coverage will, in the end, cost the state more to provide that care, the credits proposed in this bill can be viewed as a long-term investment on the part of taxpayers that will insure that future taxpayers will not be asked to pick up the tab for long-term care for a growing segment of the population.

That said, lawmakers should not overlook the fact that unless the necessary services and facilities are available and in ample supply, no amount of insurance or money will be able to access the needed care. Like early childhood care and education the same trilemma of affordability, accessibility and quality apply to long-term care as well.

Digested 3/17/08