Review of the Effectiveness of Virginia Tax Preferences

Report to the Governor and The General Assembly of Virginia
Chapter 4

Long-Term Care Insurance Deduction and Credit Do Not Appear to Effectively Encourage Individuals to Purchase Insurance

Virginia has a tax deduction and credit intended to encourage individuals to purchase private long-term care health insurance (Table 28). Both preferences were enacted to reduce long-term care costs to individuals and/or the State. Of the two, the deduction provides a greater reduction in taxpayers' liability ($8.0 million in TY 2008). In comparison, the credit reduced taxpayers' liability by $1 million in TY 2008. Although utilization of private long-term care insurance has increased in recent years, these preferences do not appear to be responsible for such increases.

Table 28: Two Tax Preferences That Promote Long-Term Care Insurance Were Evaluated

Tax Preference *(Reduced Tax Liability [a])*	**Public Policy Purpose**	**Description**
Long-Term Health Care Deduction *($8.0 million)*	Encourage individuals to purchase long-term care insurance, thereby reducing costs to individuals and/or the State.	Grants individuals a tax deduction on the amount paid annually in long-term care insurance premiums.
Long-Term Health Care Credit *($1.1 million)*	Encourage individuals to purchase long-term care insurance, thereby reducing costs to individuals and/or the state.	Grants individuals a tax credit for 15 percent[b] of the insurance premium paid on long-term care insurance during the first 12 months of coverage.

[a] Estimates based on JLARC staff analysis of income tax return data from tax year 2008.
[b] Legislation to increase the credit to 30 percent of the premium paid was passed by the 2011 General Assembly but will only take effect if reenacted by the 2012 General Assembly.

Source: JLARC staff analysis of the *Code of Virginia* and TAX documents.

Long-Term Care Insurance Coverage Is Increasing, but Coverage Not Greatly Influenced by Preferences.

Individual utilization of private long-term care insurance has grown in recent years. According to TAX records, the total dollar amount of long-term care tax deductions increased over 3,000 percent between 2000 and 2008. Additionally, TAX data show that the number of deduction claimants has increased in recent years. From 2005 to 2008 alone, the number of tax returns filed claiming the long-term care deduction rose by 22 percent.

Despite recent increases, Virginia's tax preferences may not promote greater long-term care insurance utilization than would occur in their absence. According to the research literature, long-term care tax preferences have a limited impact on the rate at which individuals purchase insurance. In 2006, the University of Hawaii assessed long-term care insurance sales across states and found that tax preferences did not promote any more sales of insurance policies than those that would have otherwise occurred. Similarly, a 2009 analysis of long-term care insurance by researchers from Harvard Medical School found that tax incentives, namely deductions, are not associated with a statistically significant difference in sales of insurance policies. Although some studies claim that tax preferences positively impact individuals' decisions to purchase long-term care insurance, the majority of the research literature maintains that preferences have little effect on these purchases.

Table 29: Higher Income Individuals Receive Greater Tax Benefits from Long-Term Care Preferences (TY 2008)

	Long-Term Care Deduction		**Long-Term Care Tax Credit**	
	Income <$100,000	*Income >$100,000*	*Income <$100,000*	*Income >$100,000*
Average $ reduction in tax liability (2008)	$62	$145	$210	$315
Average % reduction in tax liability (2008)	15%	3%	14%	4%

Source: JLARC staff analysis of individual tax returns from TY 2008.

Long-Term Care Preferences Do Not Significantly Reduce Costs to Individuals and State. Virginia's long-term care tax deduction and credit do not appear to significantly reduce costs for most individuals, as appears to be both preferences' public policy goal. TAX data show that the average reduction in tax liability that individuals receive from Virginia's long-term care preferences ranges from $62 to $315, depending on income level (Table 29). Compared to the average annual premium for long-term care insurance of $2,200, these preferences reduce the cost of insurance by only three to 14 percent. For some individuals, particularly those with lower incomes, these tax benefits may not be enough to make this type of insurance affordable or promote its purchase.

According to the research literature, long-term care tax preferences are also not a cost-effective means of reducing state Medicaid costs. A study recently published in the *Journal of Economics* calculated that each dollar of foregone revenue caused by long-term care tax preferences results in only $0.84 of Medicaid savings. Further, Virginia has historically funded 50 percent of State Medicaid expenses while the federal government has funded the remaining half. Therefore, for every $1 that the State foregoes on long-term care tax preferences, Virginia would only save $0.42 in Medicaid costs, indicating that the State spends more on incentivizing long-term care through tax preferences than it saves as a result. It is also noteworthy that most long-term care preference claimants are not lower income taxpayers and thus may not have needs for publicly funded long-term care through Medicaid. Rather, the majority of deduction (83 percent) and credit (88 percent) claimants have annual incomes above $50,000 per year, and may not be Medicaid eligible unless their income dramatically decreases and/or they have very high medical expenses and no substantial assets.

Federal vs. State Deduction
The federal deduction requires individuals to itemize their medical expenses and have medical expenses that exceed 7.5 percent of their federal adjusted gross income. Virginia's unique State deduction does not require individuals to itemize or have a certain amount of medical expense.

Virginia Offers Tax Credit in Addition to Deductions Available in Most Other States to Promote Long-Term Care Insurance Coverage. Unlike most states, Virginia has three tax preferences to encourage individuals to purchase long-term care insurance. In Virginia, individuals can claim the federal tax deduction, the unique State tax deduction, or the State tax credit, though only one preference can be claimed for each dollar of long-term care insurance premium paid. The majority of other states only have two long-term care tax preferences, namely the federal deduction and a unique state deduction. Of the ten states that share similar socioeconomic characteristics with Virginia, four offer both the federal deduction and a state tax credit, including Colorado, North Carolina, Maryland, and Minnesota. Two states, Arizona and New Jersey, offer only a state deduction, while California offers only the federal deduction. Finally, four states offer no tax preferences at all: Pennsylvania, Michigan, Illinois, and Washington.