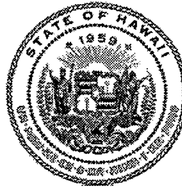
LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

LATE

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON HUMAN SERVICES & PUBLIC HOUSING

TESTIMONY REGARDING HB 584 HD 2
RELATING TO TAXATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 13, 2008
TIME: 1:15PM
ROOM: 016

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 Department of Taxation **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.

[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, HD2, RELATING TO TAXATION

March 13, 2008

LATE

Senator Suzanne Chun-Oakland, Chair
Committee on Human Services and Public Housing
Senator Will Espero, Chair
Committee on Public Safety
State Senate
Hawaii State Capital, Conference Room 016
415 S. Beretania Street
Honolulu, HI 96813

Dear Chair Chun-Oakland, Chair Espero and Committee Members:

Thank you for the opportunity to testify in support of House Bill 584, HD 2, 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, 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

Oren T. Chikamoto
737 Bishop Street, Suite 2100
Honolulu, Hawaii 96813
Telephone: (808) 524-3800
Facsimile: (808) 523-1714

LATE

TO: Senator Suzanne Chun Oakland, Chair
Senator Les Ihara, Vice Chair
Committee on Human Services and Public Housing

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

RE: HB 584, HD2, providing a long term care insurance tax credit
scheduled for testimony 3.13.2008 at 1:15pm, Conference Room 016

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 HD2 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 HD2.

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 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%)**

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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%.

Missouri	an individual may deduct 50% of premium costs from state adjusted gross income	\$30	**(3%)**
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%)**

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[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