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Saint Louis University Health Policy Legislative Analysis Team<sup>1</sup>  
**MISSOURI STATE HEALTH POLICY BRIEF #3**  
*For the Missouri Foundation for Health (MFH)*

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**Analysis of Legislation to Expand Tax Deductibility  
for Long-Term Care in Missouri**

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Three recently proposed pieces of legislation (House Bills 1121, 1145, and 1359) in the Missouri Legislature would allow Missouri residents to deduct from their taxable income 100% of all non-reimbursed amounts paid for long-term care insurance premiums.<sup>2</sup> In general, this expands the deductibility of long-term care insurance premiums, since only 50% of the premiums are currently deductible.

This Policy Brief presents the legislation proposed in Brief and compares it to current Missouri statute, discusses in general the market prospects for long-term care insurance to solve the financing problem for those in need of long-term care, and concludes by assessing how the proposed legislation would affect Missouri residents and affect their access to long term care.

**Provisions of Proposed Legislation and Current Law**

In general, all three proposed pieces of legislation would allow Missouri residents to deduct a larger share of their long-term care insurance (LTCI) premiums than is currently allowed under Missouri law. Under current law, taxpayers may deduct one-half of the annual premium cost from taxable income.

Under the proposed pieces of legislation, Section A.35.096, RSMo, would be amended to allow a Missouri resident would be able to deduct their individual Missouri taxable income *“an amount equal to one hundred percent of all nonreimbursed amounts paid by such individual for qualified long-term care insurance<sup>3</sup> premiums to the extent such amounts are not included in the individual's itemized deductions.”* (Provision contained in all three pieces of legislation, HB1121, HB1145, and HB 1359)

In general, this legislation would double the deductibility of LTCI premiums for those who qualify. Individuals who purchase qualified LTCI policies are allowed, on their federal income tax return, to deduct a portion of their premiums up to a maximum limit set in the federal tax code (provided the taxpayer itemizes deductions and has medical costs in excess of 7.5% of “adjusted gross income”).<sup>4</sup> The proposed legislation allows a 100% deduction of the annual premium that is not limited by or dependent upon any other factor -- a line would be created on the tax return where the premium amount is inserted, to be subtracted from taxable income.

**The Long-Term Care Insurance Market in Missouri and the U.S.**

Size of LTCI market. Private long-term care insurance sales have been growing, but only 6 million people have a current policy, and market penetration rates remain low, with less than 10% of the population 50 and older holding policies in 41 states.<sup>5</sup> The average age of purchase is 67. In Missouri, in 2004 approximately 125,200 individuals were insured with LTCI policies,

sold by 96 different companies, for a total premium of about \$165.5 million.<sup>6</sup> A second study also shows that LTCI penetration rate, measured as the number of policies sold in state as a percentage of people over 50 living in that state, is higher in Missouri (10% - 14%) compared to most other states. Four other states have the same penetration rate as Missouri and only five other states have a higher penetration rate.<sup>7</sup>

There are several reasons why the LTCI market has not grown more rapidly, related to both lack of demand for the product, as well as lack of supply.<sup>8</sup> On the demand side, the price of a LTCI insurance policy is high, reflecting not only the high price of long-term care services (e.g., the estimated annual cost of a nursing home stay is over \$70,000), but also increasing risks as a person ages leading to premiums that rise steeply with age.<sup>9</sup> As a result, policies are not affordable to the vast majority of persons, especially as they age, if the individual is already using long term care, or if the individual already has significant health problems. Estimates conclude that only 39% of people age 60 to 64 could afford a policy, declining to only 5% of those age 75 to 79. On the supply side, LTC expenditures are quite unpredictable in the long run, due to rapidly rising prices, changing technology, and other factors. This leads to higher premium prices and for the reluctance of some sellers of policies to enter into the market.

Distribution of purchasers of LTCI, by income. By all indications, LTCI is purchased primarily by higher income persons, for a couple of reasons. While only 27% of the general population over age 55 has incomes of \$50,000 or greater, 42% of LTCI purchasers have incomes above this amount (Table 1).<sup>10</sup>

Also, while only 7% of the population age 55 or older has assets of over \$100,000, 71 percent of the purchasers of LTCI have assets of \$100,000 or more. By all indications, persons with higher incomes and assets are more likely to purchase LTCI because the price of LTCI is so high (requiring a large income to make the premiums affordable) and because those with larger asset portfolios have more assets to protect. The trend is also important. The share of LTCI policies purchased by individuals with income

Table 1.

Income and Assets of Individual Long-Term Care Insurance Buyers, Nonbuyers, and the General Population Age 55 and Over, 2000

	General Population (age 55 or older)	2000 Buyers	1995 Buyers	1990 Buyers
<b>Income Status</b>				
Less than \$20,000	--.	9%	21%	29%
\$20,000-\$24,999	46%[1]	8	16	13
\$25,000-\$34,999	14	19	24	20
\$35,000-\$49,999	13	22	18	17
\$50,000 and over	27	42	20	21
<b>Total Liquid Assets</b>				
Less than \$20,000	60%	6%	18%	16%
\$20,000-\$29,999	9	5	10	8
\$30,000-\$49,999	10	7	13	11
\$50,000-\$74,999	9	5	10	12
\$75,000-\$99,999	6	6	8	11
\$100,000 and over	7	71	41	42

NOTE: 1. 46% of persons have less than \$25,000 in income.  
 SOURCE: LifePlans, Inc. 2000. "WHO BUYS LONG-TERM CARE INSURANCE IN 2000? A Decade of Study of Buyers and Nonbuyers," Prepared for Health Insurance Association of America, October 2000, [http://www.ahipresearch.org/pdfs/17\\_WhoBuysLTCI2000.pdf](http://www.ahipresearch.org/pdfs/17_WhoBuysLTCI2000.pdf)

of \$25,000 or less dropped from 42% in 1995 to 17% in 2000 while the share of policies purchased for those with income of over \$50,000 rose from 21% to 42%. Similarly, the share of LTCI policies purchased by those with less liquid assets over \$100,000 rose from 42% in 1995

to 71% in 2000.

Further differences are also apparent in the type of LTCI policies purchased:

- persons who made less than \$20,000 were more likely to chose policies in which duration of benefit was 1-2 years; in contrast, only 9% of those with income over \$50,000 bought similar policies;
- persons with income of less \$20,000 bought policies with lifetime benefits, while 40% of policies bought by persons making over \$50,000 had lifetime benefits;
- individuals with lower income are more likely to purchase policies which allows for care in only nursing homes while higher income individuals buy more comprehensive policies allowing for **care in** both nursing homes and **in their** own homes, and policies with a higher daily benefit.
- Finally, federal employees and privately sponsored group long term insurance buyers tend to be highly education (over 70% with college degree), tend to have income over \$75,000 (over 56%), and/or have assets over \$100,000 (over 55%).<sup>11</sup>

### **Effects of Expanding Long-Term Insurance Deductibility in Missouri**

- Fiscal effects: State officials estimate that expanding deductibility of LTCI would lead to a \$2.7 million drop in revenue in Fiscal Years 2006 and beyond.<sup>12</sup>
- Impact on Medicaid: State officials from the Department of Social Services state that the increased deduction is unlikely to have any fiscal impact of their department. Department officials state that substantial savings to state Medicaid program is unlikely and that there are no conclusive evidence linking tax deductions and Medicaid savings.<sup>13</sup> As discussed below, increase in the tax deduction will likely have a small 1% increase in LTCI purchase among higher income and/or higher asset owning individuals. The likely purchasers of LTCI are the same individuals who are not likely to use Medicaid for LTC even in the absence of LTCI. Thus, even if there are savings, the savings are not likely to be substantial.
- Individuals affected by expanded deductibility: The estimate of the Fiscal Effect of the expanded LTCI deduction appears to be based on a “static” estimate of the number of persons that would take the LTCI credit, that is, it is based on the amount of deductions claimed in FY2005 for the Long Term Care Tax Credit (\$60.8 million). The fiscal effect was figured by applying the state marginal rate to this amount, and doubling the effect, since the size of the deduction will double.<sup>14</sup> Thus, these estimates assume that the claimed deductions will not change, which is likely to occur only if the additional deduction does not stimulate new demand for LTCI.

If instead some new policies are purchased, what is a reasonable estimate of the number of new policies would be purchased as a result of the tax policy? Estimating this requires using economic analysis<sup>15</sup>, drawing upon a number of assumptions about the responsiveness of individuals to premium price changes.<sup>16</sup> Using these assumptions and other information on marginal tax rates and the current size of the LTCI market in Missouri, analysis suggests that only about 50 more Missourians will purchase long term care insurance.<sup>17</sup> It should be noted that the impact suggested above may be somewhat overstated. State and federal tax obligations are linked -- to the extent individuals claim higher LTCI deduction and pay lower Missouri taxes, their federal deduction for states taxes paid will also be reduced. This offset, therefore, reduces the effect of an increased

Missouri deduction, reducing the effectiveness of state tax deductions to induce individuals to purchase new LTCL policies in Missouri.

- Distributional effects of expanded tax deductibility. Since the increase in tax deduction is unlikely to stimulate increases in LTCL purchase, the tax deduction will really be an additional subsidy to existing policy holders. Who are these existing LTC insurance policy holders? In 2000, almost all policies were sold to individuals over the age of 55, with average age of about 67 years. In addition, 47% of the LTC policy buyers had a college education with an additional 27% having some post high school education. Thus, 74% of LTC insurance buyers had more than a high school education. In addition, as noted above, individuals making over \$50,000 purchased 42% of all policies sold, while those with liquid assets of over \$100,000 bought 71% of all LTCL policies sold (Table 1). Finally, higher income individuals also purchase policies that are more comprehensive, policies that have longer duration levels and higher daily benefit levels.

Given these facts, the proposed increase of tax deduction from 50% to 100% of LTC insurance premiums is likely to overwhelmingly benefit those with higher incomes and higher liquid assets. First, those with higher incomes and assets are holders of existing LTC policies which are also more comprehensive in benefits offered. Since a large proportion of LTC premiums are paid by those with higher incomes and assets, these individuals will be able to deduct 100% of the premiums instead of 50%. Second, higher income individuals also pay taxes at a higher marginal tax rate, and thus the tax savings accruing to a higher income individual will be larger even when a lower income individual buys exactly the same policy as a higher income individual. A tax deduction, therefore, is regressive, with higher income individuals receiving a proportionally greater share of the benefits. A fairer alternative would be to allow individuals to claim a tax credit (capped at an appropriate level) for LTCL premiums, allowing individuals to reduce their taxes by the same amount irrespective of income. The dollar for dollar reduction in taxes benefits those with lower income, provided that individuals with lower income have sufficient tax obligations against the person could claim the entire tax credit allowed.

- Expected Effects on affordability of Long-Term care. Relative to median income, the premium for a standard policy is indeed high and unaffordable for many.<sup>18</sup> While reduction in taxes help, the rather small amount is unlikely to move many people from the ranks of people who cannot afford LTCL to the ranks of those who can afford LTC, and thus the effect on the affordability of long-term care will be negligible. Tax deductions do not encourage the purchase of LTCL policies because deductions do not target taxpayers who would not have purchased a policy without the deduction. First, LTCL is expensive and, second, Medicaid lowers the incentive to purchase LTCL on the demand side. Even a 100% deduction does not provide a dollar-for-dollar reduction in the cost; it only allows a taxpayer to defray the applicable percentage of his or her LTCL multiplied by his or her marginal tax rate, and this only if the person has tax liability.<sup>19</sup>

## CONCLUSIONS

The proposed legislation discussed here would expand the deductibility of long-term care insurance in Missouri. Given the small size of the tax subsidy that would flow to recipients, and how little this will reduce the price of long-term care insurance, it is expected that only a handful of new LTCL policies will be bought by Missourians as a result of the increased tax deduction. The primary beneficiaries of the expanded deduction will be existing policy holders of LTCL, who

are largely individuals from the upper middle class or higher income groups. Therefore, this program will have only a negligible impact on the persons needing long-term care in Missouri and the program will not lead to significant increases in access to long term care.

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#### ENDNOTES:

- <sup>1</sup>The Saint Louis University State Health Policy Legislative Analysis team consists of 16 analysts from the Schools of Public Health, Law, Business, Public Service, and Medicine. The analysts are: Timothy McBride, Heather Bednarek, Michael Counte, Kanak Gautam, Daniel Gentry, Barbara Gilchrist, Kathy Gillespie, Thomas Greaney, Muhammad Islam, Heidi Israel, Richard Kurz, Ana Maria Lomperis, Doug Luke, Nicolas Terry, Sidney Watson, and Kathleen Wyrwich. The work of the Saint Louis University Health Policy Legislative Analysis Team is funded by the Missouri Foundation for Health (MFH) but the views represented here are those of the analysts and do not represent the views of the Missouri Foundation for Health or Saint Louis University.
- <sup>2</sup> This legislation can be found on the Missouri Legislative Bill Tracking internet site: HB 1121 [ <http://www.house.mo.gov/bills061/bills/hb1121.htm> ], HB1145 [ <http://www.house.mo.gov/bills061/bills/hb1145.htm> ], HB 1359 [ <http://www.house.mo.gov/bills061/bills/hb1359.htm> ].
- <sup>3</sup> It is worth noting that for the purposes of the legislation, "qualified long-term care insurance" will mean any policy "which meets or exceeds the provisions of sections 376.1100 to 376.1118, RSMo, and the rules and regulations promulgated pursuant to such sections for long-term care insurance."
- <sup>4</sup> The current limits on the deductibility of LTCI premiums are: age 40 years or under, \$200; age 41-50, \$375; age 51-60, \$750; age 61-70, \$2,000; age 71 or older, \$2,500 [Source: 26 U.S.C. §§213 and 7702B, 26 USC § 213(10)(A)]
- <sup>5</sup> Kaiser Family Foundation. 2006. "Private Long-Term Care Insurance: A Viable Option for Low and Middle-Income Seniors?", February. Found on the Internet at [ <http://www.kff.org/uninsured/upload/7459.pdf> ]
- <sup>6</sup> Data obtained from Missouri Department of Insurance from web site, <http://www.insurance.mo.gov/reports/suppdata.htm>
- <sup>7</sup> America's Health Insurance Plans, (2004), "Long Term Care Insurance in 2002," [www.ahipresearch.org/pdfs/18\\_LTC2002.pdf](http://www.ahipresearch.org/pdfs/18_LTC2002.pdf)
- <sup>8</sup> A range of publications discuss and describe the long-term care marketing detail. See for example: Jeremy Pincus, "Employer Sponsored Long-Term Care Insurance," EBRI Issue Brief, 2000 [ <http://www.ebri.org/pdf/briefspdf/0400ib.pdf> ], Robert Friedland, "Facing the Costs of Long-Term Care" EBRI, 1990 [ [http://www.ebri.org/pdf/publications/books/facing\\_costs\\_of\\_long\\_term\\_care.pdf](http://www.ebri.org/pdf/publications/books/facing_costs_of_long_term_care.pdf) ], Richard Johnson, "Is Private Long-Term Care Insurance the Answer?" Urban Institute Issue Brief #29, March 2005 [ <http://www.urban.org/UploadedPDF/1000795.pdf> ], Douglas Holtz-Eakin, "The Cost and Financing of Long-Term Care Services," testimony before the Subcommittee on Health Committee on Ways and Means, U.S. House of Representatives, April 19, 2005 [ <http://www.cbo.gov/showdoc.cfm?index=6294&sequence=0> ].
- <sup>9</sup> While half the elderly have incomes below \$25,000, the annual cost of a typical LTCI policy in 2002 was \$1,474 if purchased at age 50; increasing steeply with age, to \$2,862 at age 65 and \$8,991 at age 79.
- <sup>10</sup> America's Health Insurance Plan's (2000), "Who Buys Long Term Care Insurance in 2000? A Decade of Study of Buyers and Non-Buyers," [http://www.ahipresearch.org/pdfs/17\\_WhoBuysLTCI2000.pdf](http://www.ahipresearch.org/pdfs/17_WhoBuysLTCI2000.pdf)
- <sup>11</sup> US Department of Health and Human Services, 2004, "A Demographic and Attitudinal Profile of Buyers of the Federal Long Term Insurance Program," <http://aspe.hhs.gov/daltcp/reports/buyprof.htm> See also, "A Comparative analysis of the Socio-Demographic and Attitudinal Characteristics of Active Buyers and Non-Buyers of Long-Term Care Insurance in the Federal, Private and Public Sectors," <http://aspe.hhs.gov/daltcp/reports/LTCIchar.htm>
- <sup>12</sup> Committee on Legislative Research, Oversight Division, Fiscal Note, SB 918, February 7, 2006, [www.moga.state.mo.us/oversight/over06/fispdf/4586-01n.org.pdf/](http://www.moga.state.mo.us/oversight/over06/fispdf/4586-01n.org.pdf/)
- <sup>13</sup> *ibid*
- <sup>14</sup> Using a 4.5% marginal tax rate, General Revenue was reduced by \$2,736,000 from the 50% deduction. Therefore, the Fiscal Note assumes an additional \$2,736,000 in lost revenue to the General Revenue Fund if the deduction is increased from 50% to 100%.
- <sup>15</sup> Sources: Royalty, Anne Beeson and John Hagens, (2003), "The Effect of Premiums on the Decision to Participate in Health Insurance and Other Fringe Benefits Offered by the Employer: Evidence from a Real World Experiment," Economic Research Initiative on the Uninsured, Working Paper 23. Pincus, Jeremy, (2000), "Employer Sponsored Long Term Care Insurance: Best Practices for Increasing Sponsorship," EBRI Issue Brief Number 220.
- <sup>16</sup> The impact of the proposed increase in tax deduction from 50% to 100% of LTC insurance premiums will depend on the age at which individuals purchase the insurance. Nationally, the average age at which LTC insurance is purchased is approximately 59 years. If Missourians purchase at about the same age, a price elasticity between -.38 reported by Pincus and the slightly higher, non-age specific, number of -.468 reported by Royalty and Beeson would be relevant. For the purposes of this brief, we use a price elasticity of -.45.
- <sup>17</sup> Missourians pay state taxes at rates between 3% and 6% of Missouri taxable income. The Missouri Department of

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Revenue, in its Fiscal Note attached to SB 918 applied a tax rate of 4.5% to claimed deduction for LTC insurance premiums. 100% deduction of LTC insurance premium would reduce the effective price of LTC insurance by this 4.5%. In 2004, 125238 Missourians had LTC insurance and paid about \$165 million in premiums. The average yearly premium, according to this, is about \$1332. Allowing 100% deduction of these premiums decrease effective cost by about \$59.4, of which half, or \$29.7 would be additional reductions because individuals are allowed to deduct 50% of the premiums under current law. How will this additional reduction in effective cost of impact the purchase of LTC insurance? Since the average state tax rate of 4.5% reduces the effective price by 4.5%, and each percent reduction in effective increases demand by the elasticity of demand of  $-.45$ , 100% deduction would result in  $.45 \cdot .045 = .02025\%$ , or a 2% increase in the number of LTC insurance policies purchased. Since Missouri currently allows for a 50% deduction in LTC insurance premiums, increase of the deduction from 50% to 100% will increase purchase of LTC Insurance by about 1%. Between 2000 and 2004, the number of LTC policy holders has gone from 100580 to 125238. Thus, on average, an additional 5000 Missourians have purchased LTC insurance each year for the past 5 years. Since the increase in deduction from 50% to 100% stimulates demand by an additional 1%, approximately 50 more Missourians will purchase long term care insurance.

<sup>18</sup> The annual premium on a standard policy that provides for \$150 in daily benefit, 4 years of coverage, a 90 day elimination period, and a 5% compounded inflation protection bought by a 65 year old was \$2346 (in 2002) (Source: America's Health Insurance Plans, (2004), "Long Term Care Insurance in 2002," [ [http://www.ahipresreach.org/pdfs/18\\_LTC2002.pdf](http://www.ahipresreach.org/pdfs/18_LTC2002.pdf)]. The 2002 median income of older persons (65+) was \$19,436 for males and \$11,406 for females. Households headed by someone over 65 had median income of \$33,802. (Income source: US Department of Aging, "A Profile of Older Americans: 2003," <http://aoa.gov/prof/Statistics/Profile/2003/2003Profile.doc> ). An individual who pays taxes at the marginal tax rate of 4.5% would reduce taxes by \$105. Thus, the increased deduction from 50% to 100% will lower the effective price of LTCI by \$52. For someone who pays taxes at the marginal tax rate of 3%, the increased deduction will reduce effective price of LTCI by \$35.

<sup>19</sup> Karin C. Ottens, Using Tax Incentives to Solve the Long-Term Care Crisis: Ineffective and Inefficient, 22 Va. Tax Rev. 747 (2003), pp. 763 – 764.