

File: long-term
care

Wendy Katz

From: Neera Tanden
Sent: Thursday, February 03, 2000 1:18 PM
To: Wendy Katz
Subject: FW: long term care: let me know what more we need, otherwise i'm working on education

Please fax this to 202-456-2878 for Ann O'Leary.

-----Original Message-----

From: Elizabeth Condon
Sent: Thursday, February 03, 2000 12:37 PM
To: Neera Tanden
Subject: long term care: let me know what more we need, otherwise i'm working on education

Long Term Care Insurance Deduction

At least 19 states have established tax deductions or tax credits for long-term care insurance premiums. Last year, Congress passed legislation that would have provided a 100 percent tax deduction for long term care insurance premiums, but it was part of the \$792 billion tax-cut bill that the President vetoed. Republican Presidential candidate George W. Bush will likely propose establishing a tax deduction for the purchase of long-term care insurance. Senator John McCain's tax plan includes an unspecified tax deduction for long-term care expenses. Senator Charles Grassley's (R-IA) *Long-Term Care and Retirement Security Act (S.35)* would allow tax deductions to encourage people to buy long-term care insurance. House Ways and Means Committee Chairman Bill Archer (R-TX) supports the deduction. Congress's Joint Committee on Taxation estimates the cost of an above-the-line federal tax deduction for long-term care insurance premiums at \$8.7 billion over 10 years, while the White House estimates the cost of its long-term care initiative to be \$28 billion over 10 years.

Last year, Congressman Gene Green (D-TX) introduced legislation, the *Health Insurance Tax Deductibility Act* (H.R. 145), to provide for the phased-in, full deduction of the premium costs of "qualified" long term care insurance and medical care. The American Health Care Association strongly supports his bill.

newer long-term
care

February 4, 2000

MEMORANDUM FOR HILLARY RODHAM CLINTON

FROM: ANN O'LEARY

CC: MELANNE VERVEER

SUBJECT: LONG-TERM CARE

I understand from Neera that you are considering proposing a tax deduction for long-term care insurance. In considering this option, I wanted to be sure that you had full information on the rationale for the Administration's proposal to offer a tax credit for long-term care *expenses*, the Republican's long-term care tax deduction proposal, and the analysis conducted by the Center on Budget and Policy Priorities.

Administration's Proposed Tax Credit for Long-Term Care Expenses

The budget proposes a 10-year, \$28 billion package to address the problem of long-term care. As part of this package, the Administration has proposed a \$3,000 tax credit to compensate people with long-term care needs or their caregivers for the cost of care. This credit would be phased in beginning with \$1,000 in 2001 and rising in \$500 increments, so eligible people would receive \$3,000 in 2005 and thereafter. The credit would be phased out beginning at \$110,000 for couples and \$75,000 for unmarried taxpayers. This new tax credit supports the diverse needs of families by compensating a wide range of formal or informal long-term care for people of all ages with three or more limitations in activities of daily living (ADLs) or a comparable cognitive impairment. It would provide needed financial support to about 2 million Americans, including 1.2 million older Americans, over 500,000 non-elderly adults, and approximately 250,000 children per year. It costs about \$8.8 billion over five years and \$26.6 billion over 10 years.

The rationale for providing a tax credit for long-term expenses was to target the low and middle-income tax payers who are struggling to pay for long-term care costs and have few excess resources to cover their out-of-pocket expenses. (WHAT MORE CAN I SAY??)

Republican's Long-Term Care Proposal

A tax deduction for long-term care insurance was included in the Republican Tax package vetoed by the President, and is now included in the Domenici Minimum-Wage and Tax Amendment passed as part of the Bankruptcy Reform bill in the Senate. This proposal would allow for a deduction for 100% of the premiums paid to purchase long-term care insurance (CEILING??). COST??

According to the Center for Budget and Policy Priorities, the beneficiaries of this proposal are likely to be higher-income taxpayers who currently carry long-term insurance, and taxpayers in the higher tax brackets for whom a deduction makes the purchase of long-term care an attractive option (see attached analysis with long-term care piece highlighted).

Ann O'Henry



CENTER ON BUDGET AND POLICY PRIORITIES

January 28, 2000

SENATE BANKRUPTCY BILL NEARING PASSAGE INCLUDES COSTLY TAX CUTS THAT COULD HARM LOWER-WAGE WORKERS

by Iris J. Lav and Robert Greenstein

Bankruptcy legislation the Senate is expected to pass the week of January 31 includes a series of tax cuts costing \$76 billion over 10 years that not only would largely benefit higher-income individuals but also are likely to lead to *reductions* in employer-provided pension and health benefits available to less well-compensated workers. These tax breaks were inserted into the bankruptcy bill last November as part of a package offered by Senator Don Nickles. That package included both a version of minimum wage legislation scaled back from the increase Senate Democrats had proposed and a series of tax cuts ostensibly intended to offset the effect of increased wages on small businesses. Most of the tax reductions, however, would benefit higher-income individuals who do not work in small businesses.

- The bankruptcy legislation includes the pension tax provisions of the tax bill that Congress passed and the President vetoed last summer. The pension provisions were among those cited as unacceptable in the President's veto message. The principal impact of the pension changes would be a major expansion of pension-related tax preferences for high-income individuals. Moreover, some of the provisions being considered could lead to a reduction in pension coverage among lower-income workers and those employed by small businesses.
- A costly new "above-the-line" deduction for health insurance premiums paid by individuals who purchase their own insurance — or whose employers subsidize less than 50 percent of the cost of health insurance premiums — also is included. This provision is likely to do little to make health insurance affordable for most of the nation's uninsured, 93 percent of whom either owe no federal income taxes or are in the 15 percent bracket and thus would at most receive a subsidy of 15 cents for every dollar spent on health insurance. Moreover, because the deduction would provide a far deeper percentage subsidy for purchasing health insurance to higher-paid business owners and executives than to lower-wage earners, it could encourage some small business owners to drop group coverage (or not to institute it in the first place) and to rely on the deduction for their own coverage. To the extent this occurs, the ranks of the uninsured and underinsured among low- and moderate-wage workers could increase.
- The bill includes a new deduction for 100 percent of the premiums paid to purchase long-term care insurance, which — like the health insurance deduction

— would provide the largest benefit to the highest-income taxpayers. Most low- and middle-income taxpayers would get no more than a 15 percent subsidy for the cost of long-term care insurance; this is too little to enable such an insurance policy to fit within the budgets of many middle- and lower-income families. This proposed deduction stands in sharp contrast to the provision President Clinton is proposing in his new budget, which is a *tax credit* for long-term care *expenses* incurred by middle-income families in caring for elderly or disabled relatives. Unlike the deduction, the tax credit does not favor taxpayers in high tax brackets. And unlike the deduction, which relieves the cost of buying insurance and thus helps only those families that can afford to buy an insurance policy to protect them from potential future long-term care expenses, the Clinton proposal relieves expenses actually incurred today by families that are hard-pressed by long-term care costs and are likely to have few excess resources.

- The legislation would relax limitations on the extent to which business could deduct a “three-martini lunch.” Businesses currently may deduct 50 percent of business meals and drinks, a limitation intended to prevent excessively luxurious dining and drinking at taxpayer expense. The tax provisions in the bankruptcy legislation would raise to 80 percent the proportion of business meals and drinks that can be deducted by businesses with receipts up to \$7.5 million a year.
- The net cost of the tax provisions included in the bankruptcy bill would be \$18 billion over the next five years and \$76 billion over ten years. By the tenth year, the annual cost would be more than \$16 billion.
- This cost is not paid for; it is simply assumed to be covered by the non-Social Security surplus. There is a substantial risk, however, that Congress will consume far more of the projected surpluses than is prudent, given that the Congressional Budget Office continues to forecast that the nation will face severe long-term fiscal problems when the baby boom generation retires in large numbers. Before rushing to pass tax cuts, policymakers need to ascertain how much of the projected non-Social Security surplus can be counted upon as likely to materialize when realistic assumptions about discretionary spending (including defense spending) are made and the uncertainty of forecasts for years more than a few years in advance is taken into account. Policymakers also need to gauge how much of these projected surpluses will be needed for use in future Medicare and Social Security solvency legislation. Finally, they need to establish a budget framework and establish priorities for the use of those surplus funds that safely can be used for other purposes. This has not been done.

The argument usually advanced for including tax measures as an accompaniment to a minimum wage increase is that small businesses need to be compensated for the increased wages they would have to pay under a higher minimum wage. This argument is not well-founded; the evidence does not indicate that modest minimum wage increases have significantly negative

effects on small businesses. For example, recent research that examined whether minimum wage increases contribute to the failure rate of businesses found "...there seems to be no discernible

How Much of the Surplus is Available for Tax Cuts?

When policymakers consider how much of the surplus is available for tax cuts, several factors should be taken into account.

- Estimates of the projected surplus should reflect realistic estimates of discretionary spending, including defense spending. Estimates of amounts of surplus funds available for tax cuts or program expansions also need to reflect the costs of legislation that is virtually certain to be enacted, such as legislation to extend the array of expiring tax credits that Congress extends every year or two, to change the Alternative Minimum Tax so it does not hit increasing numbers of middle-class families, and to provide additional payments to farmers beyond those the Freedom to Farm Act provides, as Congress has done each of the past two years. Such legislation, which is not reflected in the CBO or OMB projections of the surplus, could reduce the available surplus by close to \$250 billion over 10 years.
- Consideration should be given as well to the fact that a high degree of uncertainty surrounds budget forecasts for years more than five years out. More than over 80 percent of the non-Social Security surpluses projected for the next 10 years would occur in the sixth through the tenth years. It is prudent to leave a substantial cushion within the projected surplus as a hedge against such uncertainty rather than to enact legislation that consumes most or all of the projected surplus.
- In addition, sufficient funds from the non-Social Security surplus need to be set aside for Medicare and Social Security so that the combination of reforms in these programs and these additional funds can restore long-term solvency to these programs and ease the nation's long-term budget problems in the process. If sufficient surplus funds are not set aside for this purpose — and solvency must be restored entirely through changes in these programs — the benefit reductions or payroll taxes entailed will be sufficiently large that it is unlikely any solvency legislation will pass for years to come.

Only when these steps are taken will policymakers be able to ascertain how much of the surplus it may be safe to use for other purposes. At that point, policymakers should adopt a budget framework establishing priorities for use of these funds. They should do so before beginning to consume these resources.

These steps have not yet been taken. In their absence, it is unwise and fiscally imprudent to rush off and commit tens of billions of dollars (and ultimately \$16 billion a year) to a series of tax cuts that almost surely would not merit placement on a list of national priorities. It is hard to argue that increasing pension tax breaks for highly paid executives, adding a new health insurance tax break largely for the already insured, and fattening the three-martini lunch deduction are priorities that should have the first claim on the nation's budget surpluses.

correlation between minimum wage increases and a rise in business failures, either in the year the increase occurred or in the following year.”¹ But whatever the merits of compensating small businesses, the tax cuts in this bill go far beyond any reasonable bounds for what might be justified as measures to cushion the effects of a higher minimum wage on small businesses. In addition to providing costly tax breaks to high-income taxpayers, most of whom do not work in small businesses, the tax cuts have the potential to hurt the very workers minimum wage legislation is intended to help.

Pension Provisions Are Poorly Targeted

The bankruptcy legislation includes the pension tax provisions of the tax bill Congress passed and the President vetoed this summer. These provisions have at most a tenuous connection to any problems that small businesses are said to experience as a result of a minimum wage hike.

The proposed pension changes would relax various provisions of current law that limit the contributions that highly paid individuals may make to pension plans, as well as the amount of the pension payments that such high-income individuals may receive when they retire. For example, the bill would increase the maximum tax-favored contribution that an employed individual is permitted to make to a 401(k) plan from \$10,000 to \$15,000. This change would primarily benefit the fewer-than-five-percent of individuals covered by a 401(k) plan who make the maximum \$10,000 contribution today; this is a group that receives average pay of \$130,000. The bill also would increase the maximum benefit that a retiree can receive under a defined benefit pension plan from \$130,000 a year to \$160,000. That change would benefit only those at the very top of the income distribution whose salaries are so large that they would be able to qualify for annual pension payments of more than \$130,000 when they retire.

These and the other pension-related tax breaks in this bill have little to do with assisting small businesses. Most small businesses, in fact, do not even offer pension plans. In 1993, only 13 percent of full-time workers in firms with fewer than 10 employees — and 25 percent of workers in firms with between 10 and 24 employees — enjoyed pension coverage. It is unlikely that many small businesses with large minimum-wage workforces would be affected by these expansions in pension tax breaks.

By contrast, 73 percent of workers in firms with 1,000 or more employees have pension coverage.² Most of the benefit of the pension provisions in this bill would accrue to highly-salaried executives of large corporations that already offer generous pension coverage.

¹ Jerold Waltman, Allan McBridge, and Nicole Camhout, “Minimum Wage Increases and the Business Failure Rate,” *Journal of Economic Issues*, March 1998.

² U.S. Department of Labor, Social Security Administration, Small Business Administration, and Pension Benefit Guarantee Corporation, *Pension and Health Benefits for American Workers*, 1994.

An analysis by the Institute on Taxation and Economic Policy finds that 91 percent of the tax benefits from the pension provisions in the vetoed tax bill would go to the 10 percent of Americans with the highest incomes. By contrast, the bottom 60 percent of Americans would receive less than one percent of these tax benefits. The effect of these provisions would be a significant increase in the tax-preferred benefits of high-income individuals, with little expansion for the middle- and low-income workers — many of whom work for small businesses — who most need to build savings for retirement.

In fact, some of the pension provisions could lead to *reduced* coverage for some low- and middle-income workers. For example, the bill would raise the amount of salary on which pension contributions may be made from \$160,000 to \$200,000. This would enable small business owners and highly-paid executives to maintain contributions for their own pension plans while reducing the firm's contributions for other employees. Consider, for instance, the case of a small business owner with compensation of \$250,000 who wants to have the business contribute \$10,000 a year to his pension. Under current law, the owner would have to set the firm's pension contribution rate at 6.25 percent of pay (6.25 percent of the \$160,000 limit is \$10,000). Both the owner and the employees would receive contributions equal to 6.25 percent of their compensation. Under the higher \$200,000 limit this bill would set, however, the business owner could reduce the firm's contribution rate for its employees to five percent and still have the firm contribute \$10,000 to his own pension. The employer contribution for an employee earning \$40,000 would drop from \$2,500 (6.25 percent of \$40,000) to \$2,000 (5 percent of \$40,000).³

Provisions in the bill also would relax pension anti-discrimination rules and other rules barring firms from treating highly compensated employees more generously than average workers. These provisions could induce further erosion in coverage among low- and moderate-paid workers.

In a November 1 letter to House Ways and Means Chairman Bill Archer commenting on identical pension provisions in legislation the House was considering (H.R. 3081), Treasury Secretary Lawrence Summers and Labor Secretary Alexis Herman strongly criticized the key pension provisions in the bill. Summers and Herman warned that the pension provisions that "...raise the maximum retirement plan contribution and considered compensation for business owners and executives and weaken the pension anti-discrimination and top-heavy protections for moderate- and lower-income workers....are regressive, would not significantly increase plan

³ The pension tax provisions in the vetoed tax bill, all of which are included in the bankruptcy legislation, are explained more fully in the Center report, *Exacerbating Inequities in Pension Benefits: An Analysis of the Pension Provisions in the Tax Bill*, by Peter Orszag, Iris Lav, and Robert Greenstein, October 8, 1999 and Peter R. Orszag, Iris Lav, and Robert Greenstein, *Criticism of CBPP Pension Analysis Rests on Selective Use of Data And Leaves Misleading Impressions*, October 28, 1999. The vetoed tax bill also included provisions that would make Individual Retirement Account tax breaks more generous; these IRA changes are not included in the Nickles minimum wage bill. (The distribution data cited above on the tax benefits that the bankruptcy bill pension provisions would provide thus do not cover the IRA expansions of the vetoed bill. Data on the distributional effects of the full package of retirement tax benefits contained in the vetoed bill, including the IRA expansions, are provided in *Exacerbating Inequities in Pension Benefits*.)

coverage or national savings, and could lead to reductions in retirement benefits for moderate- and lower-income workers.”

Health Insurance Deductions of Little Help to the Uninsured

Another provision of the vetoed tax bill included in the Senate bankruptcy legislation would create a new tax deduction for the purchase of health insurance by taxpayers who pay at least 50 percent of the cost of their health insurance premiums. At first glance, such a deduction may seem an attractive idea if it could help the uninsured obtain coverage or help small businesses cover their employees. Closer examination indicates, however, that this deduction — which would cost upwards of \$8 billion a year when fully in effect — would provide little help to most of those lacking insurance and would not significantly reduce the ranks of the uninsured. Moreover, because the deduction provides a far deeper percentage subsidy for the purchase of insurance to higher-income business owners and executives than to lower-income wage earners, it could encourage small business owners to drop group coverage and rely on the deduction to help defray the cost of their own coverage. In addition, some workers would be forced to buy more costly and less comprehensive insurance on the individual market, and the ranks of the uninsured and underinsured could increase.

The deduction would provide little subsidy to lower-income wage earners, including most workers who currently are uninsured and those workers for whom employers pay inadequate shares of premiums to make insurance affordable.⁴ Some 93 percent of all uninsured individuals either have incomes too low to incur income tax liability or pay income tax at the 15 percent marginal rate. These individuals would at most get a subsidy of 15 percent of the cost of purchasing health insurance, too little to enable most of these individuals to become insured. Rather than uninsured workers who today cannot afford the premiums required to obtain adequate health coverage, those who would receive the principal benefits from such a deduction are, by and large, individuals in higher tax brackets who already purchase individual insurance.

For low- and moderate-income families and individuals without employer-sponsored coverage, a 15 percent subsidy that leaves them with the other 85 percent of the premium cost is much too small a subsidy to make insurance affordable.

- For a family earning \$35,000 whose employer does not offer insurance, the proposed deduction would reduce the out-of-pocket cost of a typical family health

⁴ Census data show that at least 93 percent of uninsured individuals either pay no income tax or are in the 15 percent income tax bracket. Some 18 million uninsured individuals — 43 percent of all of the non-elderly uninsured — owe no income tax; their earnings are too low for them to incur an income tax liability. These uninsured individuals would receive no benefit from a tax deduction; a deduction would do nothing to make health insurance more affordable for them. Another 20 million uninsured individuals — 50 percent of the non-elderly people without health insurance — pay income tax at a 15 percent marginal tax rate. A deduction would provide these taxpayers with a subsidy equal to 15 percent of the cost of insurance not covered by an employer. General Accounting Office, Letter to The Honorable Daniel Patrick Moynihan, June 10, 1998, GAO/HEHS-98-190R, Enclosure II. The analysis is based on the 1996 Current Population Survey.

or more highly-paid employees to purchase insurance for themselves, using the more generous subsidy the deduction provides for those in higher tax brackets, without the necessity of providing coverage for lower-paid employees. As a result, the deduction could provide an incentive for some small business employers to drop group coverage, or for some owners newly launching small businesses to decide to decline to provide such coverage. To the extent this occurs, it would adversely affect some of the same workers the minimum wage legislation is supposed to help.

Other Provisions

Two other provisions in the Nickles minimum wage bill are poorly targeted. These are the deduction for the purchase of long-term care insurance and the increase in the deduction permitted for business meals.

Deduction for Long-term Care Insurance

The bill includes a provision that would allow a new deduction for 100 percent of the premiums paid to purchase long-term care insurance. This provision would cost approximately \$2 billion a year when fully in effect.

There are major problems relating to access to long-term care that need to be addressed. This proposal for a deduction for long-term care insurance premiums, however, would not help most middle-income people and could exacerbate the inequities in access and affordability that currently exist with respect to long-term care.

Three-quarters of all taxpayers, including most moderate- and middle-income taxpayers, pay federal income taxes at no higher than the 15 percent marginal tax rate. For this three-quarters of all taxpayers, a deduction would provide at most a subsidy of 15 percent of the cost of purchasing long-term care insurance. Long-term care insurance premiums are relatively expensive, and a 15 percent subsidy is unlikely to make long-term care insurance fit into the budgets of many middle-income families.⁷

The primary beneficiaries of the proposed deduction are likely to be higher-income taxpayers who currently carry long-term care insurance, and taxpayers in the higher tax brackets for whom a 36 percent or 39.6 percent subsidy makes purchase of long-term care insurance an attractive option. But these are likely to be the same taxpayers for whom long-term care access is not a major problem.

This proposed deduction for long-term care insurance may be contrasted with the *tax credit* for long-term care *expenses* incurred by middle-income families in caring for elderly or disabled relatives that President Clinton is proposing in his new budget. Unlike the deduction,

⁷ Long-term care premiums vary by the age at which the policy is purchased and the type and amount of long-term care expenses the policy will reimburse. A 1997 study by Consumers Union found premiums at age 55 ranged from \$588 to \$1,474 a year, while premiums at age 65 ranged from \$1,042 to \$3,100 a year. These policies cover individuals, so the costs for a couple would generally be double those amounts. *Consumer Reports*, October 1997.

insurance policy that carries a \$1,000 deductible from \$6,700 to \$5,860 — or from 19 percent of income to 17 percent of income.⁵

- An Urban Institute study shows that more than three-quarters of low- and moderate-income uninsured individuals will not purchase insurance that consumes more than *five* percent of their income.⁶ Few families that have forgone health coverage because they cannot afford to spend 19 percent of income on it would find coverage affordable because a deduction had lowered its cost to 17 percent of income. (It is of note that the child health block grant established in 1997 set a limit on the premiums and co-payments that can be charged under programs receiving block grant funds, with the limit being *five* percent of income for families above 150 percent of the poverty line and smaller amounts for poorer families.)

This provision might be of modest help to some moderate-income families whose employer pays half or nearly half of the premium costs since the deduction would be in addition to the employer subsidy. But even families whose employers pay 50 percent of the premium would receive only very modest help from the deduction. The deduction would reduce the proportion of the premium these families have to pay only from 50 percent of the premium to 42.5 percent. While that might help some families afford insurance, the number of such families likely would be small.

In addition, the deduction could induce some employers currently paying more than 50 percent of premium costs to scale back their contribution to 50 percent or less. And as noted, some employers may drop coverage altogether.

The group that would appear to benefit most from this deduction would be higher-income taxpayers who purchase insurance as individuals. A health insurance deduction is worth more than twice as much to affluent individuals in the 31 percent, 36 percent, and 39.6 percent brackets than to moderate- and middle-income families in the 15 percent bracket. Many of these higher-income taxpayers who would benefit already purchase insurance as individuals.

While few low- and moderate-income workers would benefit, some could be harmed by the proposal. The proposed new health insurance deduction would allow small business owners

⁵ A General Accounting Office study found that in 1996, the middle of the range of premium costs was \$5,700 for a family-coverage policy that included a \$1,000 deductible. The proposed tax deduction would provide a subsidy of \$840 for the purchase of a policy with a \$5,700 premium (\$840 equals 15 percent of \$5,700). This means the family would have to pay the remaining \$4,860, or 14 percent of its income, to purchase the health insurance policy. Since this premium is for a policy with a \$1,000 deductible, another three percent of income would have to be expended before any benefits would be available. The family's net expenditure for health coverage — the premium plus the deductible — would total \$5,860, or 17 percent of the family's income. Without the proposed tax deduction, the full cost of the policy plus the \$1,000 deductible is equal to 19 percent of the family's income.

⁶ Leighton Ku, Teresa Coughlin, *The Use of Sliding Scale Premiums in Subsidized Insurance Programs*, Urban Institute, March 1997.

the tax credit does not favor taxpayers in high tax brackets. The credit is targeted on middle-income and upper-middle-income families, phasing out beginning at \$110,000 for couples and \$75,000 for unmarried taxpayers. Furthermore, unlike the deduction, which relieves the cost of buying insurance and thus favors families that can afford to set aside money to guard against such future long-term care expenses, the Clinton proposal relieves expenses actually incurred today by families that are hard-pressed by long-term care costs and are likely to have few excess resources.

Business Meals Deduction

The bill also includes a provision to increase the proportion of business meals that small businesses (businesses with receipts below \$7.5 million a year) may deduct. Currently, businesses may deduct 50 percent of business meals and drinks. This limitation on the “three-martini lunch” is intended to prevent excessively luxurious dining and drinking at taxpayer expense. The Bankruptcy bill would raise to 80 percent the proportion of business meals and drinks that can be deducted, at a cost to the Treasury of about \$2.5 billion a year when fully in effect.