

**OPTIONS FOR REDUCING TAXATION
ON
MEDICAL SERVICES AND NURSING HOMES**

**BLUE RIBBON TAX REFORM COMMISSION
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OPTIONS FOR REDUCING TAXATION ON MEDICAL SERVICES AND NURSING HOMES

The taxation of medical services and nursing homes under the gross receipts tax has become, in recent years, a significant issue among the medical community.

The Family Committee heard extensive testimony about the effect of gross receipts tax on health care practitioners, including results from the 2002 Physician Survey conducted by the New Mexico Health Policy Commission that indicated that the gross receipts tax was the "most frequently cited answer" from physicians who indicated that they were leaving or considering leaving practice in New Mexico. A number of New Mexico taxpayers also testified about their experiences and voiced their concerns about losing doctors and other health care practitioners in their communities. The inability of doctors and other health care practitioners who operate under managed care plans to pass on the tax to consumers was cited as the primary reason why this profession should be treated differently from other professions under the gross receipts tax. From the perspective of the family, the issue is primarily one of wanting to ensure that there is an adequate supply of health care practitioners to provide health care to all members of the family.

Gross receipts tax on nursing home care places a substantial cost on families who must pay for private nursing home care from their own resources. According to a spokesman for the New Mexico Health Care Association, the average gross receipts tax paid by a family that pays for private nursing home care is approximately \$10 per day or \$3,600 for a year of care, almost the cost of a month of service.

A number of options address the issue of eliminating or reducing the gross receipts tax on medical services and nursing homes or compensating taxpayers for these taxes. The specific options and their estimated fiscal impact are shown on the Revenue Impact Table attached.

REDUCING, ELIMINATING OR COMPENSATING FOR THE GROSS RECEIPTS TAX ON HEALTH CARE PRACTITIONERS

OPTIONS

There are three options brought forth by the Family Committee that would reduce or eliminate the gross receipts tax on receipts of health care practitioners. They differ on two points: 1) the definition of health care practitioner; and 2) the type of receipts subject to the deduction. A fourth option would provide a refundable income tax credit to health care practitioners for the gross receipts tax that they pay. A fifth option, of course, is to make no changes. The options include the following:

OPTION 1. Provide a Deduction for All Receipts of All Licensed Health Care Practitioners.

"Licensed health care practitioner" includes physicians, physician assistants, chiropractic physicians, dentists, dental hygienists, osteopathic physicians, doctors of oriental medicine, podiatrists, psychologists, registered and licensed practical nurses, registered midwives, physical therapists, optometrists, occupational therapists, respiratory care practitioners and speech-language pathologists.

OPTION 2. Provide a Deduction for All Receipts of Physicians and Osteopathic Physicians.

"Physician" means a person licensed under the Medical Practice Act (physicians, physician assistants, anesthesiologists and anesthesiologists assistants). "Osteopathic physician" means a person licensed by the Board of Osteopathic Medical Examiners (osteopathic physicians and osteopathic physician assistants).

OPTION 3. Provide a Deduction for Receipts by a Managed Health Care Provider to All Licensed Health Care Practitioners for Medicare Part "C" Services or Commercial Contract Services.

"Licensed health care practitioner" includes physicians, physician assistants, chiropractic physicians, dentists, dental hygienists, osteopathic physicians, osteopathic physician assistants, doctors of oriental medicine, podiatrists, psychologists, registered and licensed practical nurses, registered midwives, physical therapists, optometrists, occupational therapists, respiratory care practitioners, speech-language pathologists and clinical laboratories.

OPTION 4. Provide a Refundable Income Tax Credit to Licensed Health Care Practitioners for Gross Receipts Tax Paid.

This option, at its broadest, would use the same definition of health care practitioner as Option 1. The health care practitioner would continue to pay the gross receipts tax and would then file for a refundable credit at the end of each income tax year. The credit would apply against either corporate or personal income tax and credit amounts would be prorated among partners or shareholders when appropriate. The credit amount could include state and local taxes or just the state share of the tax.

STRUCTURING THE OPTIONS

For each gross receipts option, there are four possible ways to structure the relief. These include the following:

(1) Providing a deduction for state and local gross receipts taxes with no specific hold harmless provision.

This would result in a revenue loss for the local government. The impact of the loss could be offset, to some extent, by providing additional revenue sources to local governments.

(2) Providing a deduction for state and local gross receipts taxes with a hold harmless provision that requires vendors to report the deduction amount by locality and then distributes the equivalent of the local gross receipts taxes foregone by the deduction back to each locality.

This option would require the state to absorb the full cost of the reduction and would complicate, to some extent, the administration of the tax.

(3) Providing a gross receipts tax credit for the state portion of the tax on health care practitioners.

This would reduce the tax rate within municipalities by 3.275 percent and in rest-of-counties areas by 5 percent. Local option rates would continue to be imposed and collected and distributed to the local governments.

(4) Providing a deduction for state and local gross receipts taxes, but allowing local governments to re-impose their taxes on health care practitioners.

This would provide local governments with the flexibility to either join the state in providing tax relief or to protect their revenue base and spending programs by re-imposing the tax.

For the income tax credit option, the state would bear the entire fiscal impact.

PROS

The following are some of the arguments in favor of eliminating or reducing the gross receipts tax on health care practitioners or providing an income tax credit:

- Eliminating or reducing the gross receipts tax will have a significant, positive impact on the income of health care practitioners in New Mexico. It will reduce the incentive for existing residents to leave the state and increase the ability of the state to recruit new ones.
- Physicians and other health care practitioners who practice under managed care plans cannot pass the tax on to consumers. This distinguishes them from other professional service providers that also pay gross receipts taxes.

- New Mexico and Hawaii are the only two states to tax receipts of health care practitioners under a gross receipts or sales tax. In addition to the economic impact of the tax, the tax has a high "hassle factor" and sends the wrong message to health care practitioners about New Mexico's medical business climate.
- The income tax credit would provide the same economic relief, but would not impact local governments. It would also, presumably, not affect contract negotiations that include or recognize the tax as a cost of doing business.

CONS

The following are some of the arguments against eliminating or reducing the gross receipts tax on health care practitioners or providing an income tax credit:

- There is no assurance that the reduction of the gross receipts tax will actually result in increased payments to health care practitioners. Since payment rates are generally negotiated between the practitioner and an insurance company or managed care organization, the reduction in tax may be seen as a reduction in the cost of doing business and be subject to a downward payment pressure.
- The federal government currently pays for approximately 75 percent of the gross receipts tax paid on services provided through Medicaid. Leveraging these federal dollars allows the state to provide more services at less cost to New Mexico taxpayers.
- According to the secretary of human services, payments under the Medicaid program may have to be reduced if the gross receipts tax is reduced.
- Removing the tax on health care practitioners runs counter to the principle of maintaining a broad-based gross receipts tax and could set a precedent for removing the tax on other services that are seen as "merit goods" or on other professions where there is a supply shortage.
- Some of the benefit of the income tax credit would be recaptured by the federal government through higher federal income taxes. Thus, the health care practitioner would not realize its full amount.
- The income tax credit does nothing to address the "hassle factor" and perception issue raised by the gross receipts tax.
- The income tax credit may not be perceived as fair by the general public. Because it would be highly visible on the income tax forms, others could also demand a tax credit for gross receipts taxes that they pay.

ISSUES

(1) Definition of health care practitioner.

How broad or narrow should the definition be? Testimony to the committee focused primarily on shortages of physicians. However, significant written testimony was received from other health care practitioners asking for equal treatment.

(2) Under the gross receipts options, which receipts should be deductible?

One option is to narrow the definition of receipts to those received from a managed health care provider to all licensed health care practitioners for Medicare Part "C" services or commercial contract services. Federal rules against states taxing federal Medicaid receipts differ from other medical receipts and warrant caution when narrowing the definition.

(3) Under the gross receipts options, what will be the effect on local governments?

The issue of whether or not to remove the local gross receipts tax, as well as the state-imposed tax, is one of the more vexing issues to be decided. If the local gross receipts tax is removed, can or should the state hold local governments harmless from the revenue loss? Many local governments have issued revenue bonds backed by gross receipts taxes. If a hold-harmless mechanism is favored, can it be devised to ensure the bondholders that the payment of bonds will not be jeopardized? Will the reduction in the gross receipts tax base affect the future confidence in and price of local gross receipts tax bonds?

(4) Conformity with the streamlined sales tax agreement.

Unlike the tax on food, the streamlined sales tax agreement would not allow the state to not tax health care practitioners and the local governments to tax them. Thus, to be in conformity with the agreement, the tax would have to be imposed by all jurisdictions or removed by all jurisdictions.

(5) Does the income tax credit raise administrative or compliance issues that need to be addressed?

REDUCING, ELIMINATING OR COMPENSATING FOR THE GROSS RECEIPTS TAX ON NURSING HOMES

OPTIONS

There are two options brought forth by the Family Committee that would reduce or eliminate the gross receipts tax on receipts of nursing homes. One is a broad deduction for all receipts, while the other is a limited deduction for Medicare receipts. A third option would provide a refundable income tax credit to individuals for the gross receipts tax that they pay on unreimbursed payments for nursing home care. A fourth option provides a 25 percent tax credit for purchase of long-term care insurance. A final option, of course, is to make no changes. The options include the following:

OPTION 1. Provide a Deduction for All Receipts of Licensed Nursing Homes.

Like other gross receipts tax deduction options, this could be structured to include state and local taxes or the state portion only. Local governments could be required to absorb the cost or a hold harmless provision could apply.

OPTION 2. Provide a Deduction for Medicare Receipts of Licensed Nursing Homes.

This also could be structured to include state and local taxes or the state portion only.

OPTION 3. Provide a Refundable Income Tax Credit for 100 Percent of State and Local Gross Receipts Taxes Paid on Unreimbursed Payments for Nursing Home Care.

This option would use the income tax system to refund to individual taxpayers the gross receipts taxes that they pay out of pocket. It addresses the concerns raised by the industry and members of the Family Committee about the large impact the tax has on those relatively few taxpayers who do not qualify for government assistance or have insurance coverage for nursing home care.

OPTION 4. Provide a 25 Percent Income Tax Credit for Purchase of Long-term Care Insurance.

This option is intended to stimulate the purchase of long-term care insurance, so that persons in the future will not face the large out-of-pocket costs addressed in Option 3.

PROS

The following are some of the arguments in favor of eliminating or reducing the gross receipts tax on nursing homes or providing income tax credits:

- Eliminating or reducing the gross receipts tax on all nursing homes would be consistent with a broader policy of not taxing medical services in general.
- Taxing nursing home care falls under the "tax on misery" category and imposes a large tax burden on individuals who may be struggling to provide the care for family members.
- The income tax credit for individuals who incur out-of-pocket costs for nursing home

care provides highly targeted relief. It does not affect Medicaid reimbursement or insurance reimbursement rates.

- The Medicare deduction was originally provided to physicians and has recently been expanded to other health care providers. This option would put nursing homes on equal footing with regard to taxing Medicare receipts.
- The income tax credit for long-term care insurance could reduce future state costs for Medicaid. Private insurance would provide an alternative to families who would otherwise try to get their family members eligible for Medicaid-supported nursing home care.

CONS

Following are some of the arguments against eliminating or reducing the gross receipts tax on nursing homes or providing income tax credits:

- A high portion of nursing home receipts are paid by Medicaid. The federal government currently pays for approximately 75 percent of the gross receipts tax paid on these receipts. Leveraging these federal dollars allows us to provide more services at less cost to New Mexico taxpayers.
- Removing the tax on nursing homes runs counter to the principle of maintaining a broad-based gross receipts tax and could set a precedent for removing the tax on other "misery" items.
- Providing an income tax credit for taxes on unreimbursed nursing home payments singles out a certain group of taxpayers unfairly. Other taxpayers may have high unreimbursed medical care payments, for example, but receive no income tax credit.
- Some of the benefit of the income tax credit for taxes on unreimbursed nursing home payments would be recaptured by the federal government through higher federal income taxes. Thus, the individual would not realize its full amount.
- The credit for long-term care insurance singles out one type of insurance unfairly. The same arguments in its favor could be made for health insurance, in general, automobile insurance, and many other consumer expenditures.

ISSUES

- (1) Under the gross receipts options, what will be the effect on local governments?
- (2) Does the income tax credit raise administrative or compliance issues that need to be addressed?