F I S C A L   I M P A C T   R E P O R T

SPONSOR McMillan

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HB 351

SHORT TITLE Unreimbursed Medical Expense Tax Deduction

SB

ANALYST van Moorsel/Dorbecker

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY15	**FY16**	**FY17**	**FY18**	**FY19**		
$0.0	($8,000.0 to zero)	($8,300.0 to zero)	($8,600.0 to zero)	($8,900.0 to zero)	Recurring	General Fund
See "Fiscal Implications"						

Parenthesis ( ) indicate revenue decreases

SOURCES OF INFORMATION
LFC Files

Responses Received From
Taxation and Revenue Department (TRD)
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

House Bill 351 adds a new section of the Income Tax Act to create an income tax deduction for certain unreimbursed or uncompensated medical care expenses. Depending on the taxpayer's filing status and adjusted gross income, the deduction would be applicable if the qualifying medical expenses are not reimbursed or compensated for by insurance or otherwise and are not included with the taxpayer's itemized deductions. Deductions would be claimed as follows:

For surviving spouses and married individuals filing joint returns:	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over $30,000	25%
Over $30,000, not over $70,000	15%
Over $70,000	10%

For single individuals and married individuals filing separate returns:	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over $15,000	25%
Over $15,000, not over $35,000	15%
Over $35,000	10%

For heads of household:	
Adjusted Gross Income:	% of medical care expenses that may be deducted
Not over $20,000	25%
Over $20,000, not over $50,000	15%
Over $50,000	10%

There is no effective date of this bill. It is assumed that the new effective date is 90 days after this session ends. The provisions of the bill apply to taxable years beginning on or after January 1, 2015.

FISCAL IMPLICATIONS

The general fund revenue impact is presented in a range because the bill's fiscal impact can be interpreted in two ways:

- TRD reports it has allowed this separately-stated deduction and included it on its PIT return forms for the past 14 years despite the deduction not being in law (see "Significant Issues"). The department's analysis notes this bill would allow the deduction to be continued to be taken for tax years 2015 and onward. TRD considers the changes in the bill to be a technical amendment and reports the bill has no fiscal impact.

  Because the deduction has been taken in previous years and is considered in the February 2014 consensus revenue estimate, enactment of the bill would not reduce general fund revenue compared with the February estimate.

  DFA's analysis notes the February general fund revenue estimate did not make an adjustment for the fact that this deduction would not be allowed for taxable year 2015, so PIT revenue would not deviate from the consensus revenue estimate by this bill becoming law. DFA contends the 2014 tax return forms have not been edited to remove this deduction, so it is still available under current law. As a result, DFA scores this bill as having zero fiscal impact.

- However, current law does not provide for this deduction. If the bill is not enacted, the deduction could *not* be taken in tax years 2015 onward, the department would not include this deduction on PIT forms, and general fund revenue would increase. As such, the status quo would be an increase in general fund revenue and fiscal impact of the bill has to be considered negative. This increase is not included in the consensus general fund revenue estimate, as the consensus group was not aware that the deduction was not permitted under current law until after the introduction of this bill. This reasoning explains the negative impact in the range shown in the revenue table.

This is a significant deduction, and it is important the Legislature is informed of its size. TRD reports the deduction is claimed on approximately one third of PIT returns, and LFC staff has requested that TRD provide data on the amount of the deduction, as this information is not included in the agency's analysis of the bill. As of the writing of this FIR, LFC staff has not received this information. LFC staff approximated the general fund cost of the deduction based on the TRD estimate of the initial deduction in 2000, using the growth rates of actual net personal income tax receipts to estimate the impact in the current forecast period of FY15-FY19. It is important to note that these estimates do not include adjustments for the implementation of the Affordable Care Act or the expansion of Medicaid. Further, the assumptions on which the estimate was made in 2000 may no longer hold, for example, the percentage of filers taking advantage of the deduction may be higher in the present day after 14 years of the deduction being available.

This bill may be counter to the LFC tax policy principle of adequacy, efficiency and equity. Due to the increasing cost of tax expenditures revenues may be insufficient to cover growing recurring appropriations.

Estimating the cost of tax expenditures is difficult. Confidentiality requirements surrounding certain taxpayer information create uncertainty, and analysts must frequently interpret third-party data sources. The statutory criteria for a tax expenditure may be ambiguous, further complicating the initial cost estimate of the expenditure's fiscal impact. Once a tax expenditure has been approved, information constraints continue to create challenges in tracking the real costs (and benefits) of tax expenditures.

SIGNIFICANT ISSUES

TRD indicates it has been allowing the deduction since taxable year 2000. Section 1 of Chapter 7 of Laws 2000 (2ns S.S.) initially enacted this deduction with a contingent effective date. The contingency language read as follows:

> "The provisions of this act shall not become effective unless Senate Bill 33 or similar bill of the second special session of the forty-fourth legislature is enacted into law and the General Appropriation Act of 2000 passed by the second special session of the forty-fourth legislature and enacted into law includes an appropriation of four million nine hundred seventy-five thousand dollars ($4,975,000) for the sole purpose of implementing an amendment to the state Medicaid plan making eligible an individual who is the parent of a child under nineteen years of age who resides with that parent and whose family income does not exceed sixty percent of the federal poverty guidelines."

Senate Bill 33 was vetoed by the governor and the appropriation of $4,975,000 was in Laws 2000 (2nd S.S.), ch. 5, but was line item vetoed. As such, the contingency was not met, the deduction did not take effect, and TRD should not have been allowing the deduction.

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is <u>not</u> met since TRD is <u>not</u> required in the bill to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD reports the impact of the bill would be minimal and necessary changes to taxpayer forms and the department's systems can be done within the annual changes.

TECHNICAL ISSUES

This bill does not contain a sunset date. The LFC recommends adding a sunset date.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

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