DESCRIPTION OF CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 4946, THE "IMPROVING ACCESS TO LONG-TERM CARE ACT OF 2002"

Scheduled for Markup
Before the
HOUSE COMMITTEE ON WAYS AND MEANS
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Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The House Committee on Ways and Means has scheduled a markup on June 18, 2002, on H.R. 4946, the "Improving Access to Long-Term Care Act of 2002." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the Chairman's amendment in the nature of a substitute to H.R. 4946.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Chairman's Amendment in the Nature of a Substitute to H.R. 4946, the "Improving Access to Long-Term Care Act of 2002"* (JCX-67-02), June 17, 2002.

A. Above-the-Line Deduction for Long-Term Care Insurance Premiums

Present Law

Under present law, the Federal income tax treatment of qualified long-term care insurance expenses is similar to the treatment of health insurance expenses.[2] As is the case with health insurance expenses, the Federal income tax treatment of qualified long-term care insurance expenses depends on the individual's circumstances.

Individuals who purchase their own qualified long-term care insurance may claim an itemized deduction for the premiums, but only to the extent that eligible qualified long-term care insurance premiums, together with the individual's medical expenses exceed 7.5 percent of adjusted gross income.[3] The amount of qualified long-term care insurance premiums that may be taken into account in determining the amount allowed as an itemized deduction is limited as follows (for 2002): $240 in the case of an individual 40 years old or less; $450 in the case of an individual who is more than 40 but not more than 50; $900 in the case of an individual who is more than 50 but not more than 60; $2,390 in the case of an individual who is more than 60 but not more than 70; and $2,990 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

Self-employed individuals may deduct a portion of qualified long-term care insurance premiums for the individual and his or her spouse and dependents. The deductible percentage of such premiums is 70 percent in 2002 and 100 percent in 2003 and thereafter.[4] The deduction applies to qualified long-term care insurance premiums, subject to the same dollar limits that apply for purposes of the itemized deduction, described above.

Employees can exclude from income 100 percent of qualified long-term care insurance paid for by the employee's employer. There is no dollar limit on this exclusion.[5] Payments made under a qualified long-term care insurance contract are excludable from gross income, subject to a dollar limitation in the case of contracts that provide for payment on a per diem or similar basis.

In order for a long-term care insurance contract to be a qualified long-term care insurance contract: (1) the contract must be guaranteed renewable; (2) the contract generally cannot provide for a cash surrender value or other money that can be paid, assigned, or pledged as a loan

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[2] The main difference between the tax treatment of qualified long-term care insurance and medical insurance is that long-term care insurance cannot be offered under a cafeteria plan.

[3] Sec. 213(d).

[4] The deduction for long-term care insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse.

[5] Unlike health insurance, long-term care insurance cannot be provided under a cafeteria plan.

or borrowed; (3) all refunds of premiums, and all policyholder dividends or similar amounts, under the contract are to be applied as a reduction in future premiums or to increase future benefits; and (4) the contract must meet certain consumer protection standards.[6] Contracts that provide for per diem or similar payments are subject to additional requirements.

The consumer protection provisions applicable to qualified long-term care insurance contracts require that (1) such contracts meet certain provisions under the model long-term care insurance act and regulations promulgated by the National Association of Insurance Commissioners, (2) the issuer of the contract discloses that the contract is intended to be a qualified policy, and (3) the issuer offer the policyholder a nonforfeiture provision meeting certain requirements.

Description of Proposal

The proposal would provide an above-the-line deduction for a percentage of qualified long-term care insurance premiums up to the present-law dollar limitations that apply under the itemized deduction.[7] The deduction would not be available to an individual for any month in which the individual is covered under a qualified long-term care insurance contract 50 percent or more of the cost of which is paid or incurred by the individual's employer (or the employer of the individual's spouse). In determining whether the 50-percent threshold is met, all plans of related employers providing long-term care insurance in which the individual participates would be treated as a single plan.

The otherwise allowable deduction would be phased out for taxpayers with modified adjusted gross income between $20,000 and $40,000 ($40,000 and $80,000 in the case of married taxpayers filing a joint return).[8] The $20,000 and $40,000 starting points for the phase-out range would be indexed for inflation.

The deductible percentage of qualified long-term care insurance premiums would be 25 percent in 2003, 2004, and 2005, 30 percent in 2006 and 2007, 35 percent in 2008 and 2009, 40 percent in 2010 and 2011, and 50 percent in 2012 and thereafter.

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[6] Sec. 7702B.

[7] The deduction only applies to premiums on qualified long-term care insurance contracts; it does not apply to long-term care expenses.

[8] Modified adjusted gross income would mean adjusted gross income determined without regard to the deduction provided by the provision and the exclusion for certain foreign earned income (sec. 911), income from Guam, American Samoa, or the Northern Mariana Islands (sec. 931), and income from Puerto Rico. Modified adjusted gross income would be calculated after the determination of the amount of Social Security benefits includible in gross income (sec. 86), the exclusion for certain interest on education savings bonds (sec. 135), the exclusion for adoption assistance (sec. 137), the deduction for contributions to individual retirement arrangements (sec. 219), the deduction for student loan interest (sec. 221), the deduction for certain education expenses (sec. 222), and the deduction for passive activity losses (sec. 469).

No amount taken into account in computing the deduction could be taken into account in determining the deduction for health insurance expenses of self-employed individuals or the itemized deduction for medical expenses. Married taxpayers would be required to file a joint return in order to claim the deduction.[9] The Secretary is authorized to prescribe such regulations as may be appropriate to carry out the provision, including appropriate reporting requirements for employers.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2002.

[9] The rules of sec. 7703 would apply in determining married status for this purpose.

B. Provide an Additional Personal Exemption to Home Caregivers of Family Members

Present Law

In determining taxable income, taxpayers are entitled to a personal exemption deduction for the taxpayer, his or her spouse, and each dependent. To qualify as a dependent under present law, an individual must: (1) be (a) a specified relative or (b) have as his or her principal place of abode for the taxable year the home of the taxpayer and be a member of the taxpayer's household[10]; (2) be a citizen or resident of the U.S. or resident of Canada or Mexico; (3) not be required to file a joint tax return with his or her spouse; (4) have gross income below the personal exemption amount if not the taxpayer's child; and (5) receive over half of his or her support from the taxpayer.[11]

The personal exemption amount for 2002 is $3,000. Personal exemptions are phased-out by two percentage points for each $2,500 ($1,250 if married filed separately) or fraction thereof by which adjusted gross income exceeds certain thresholds based on filing status. For 2002, the thresholds are $137,300 for single filers, $206,000 for joint filers, $171,650 for heads of household, and $103,000 for married taxpayers filing separate returns.[12] The exemption amount and the dollar thresholds for the phase-out are indexed for inflation.

Present law provides favorable tax treatment for the purchase of qualified long-term care insurance and for individuals with qualified long-term care expenses.

Description of Proposal

The proposal would allow a phased-in additional personal exemption for each qualified family member with long-term care needs. The exemption amount would be limited to $500 for 2003 and 2004, $1,000 for 2005 and 2006, $1,500 for 2007 and 2008, and $2,000 for 2009 and

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[10] For purposes of this rule, the taxpayer must maintain the household in which the taxpayer and the individual reside. The taxpayer is considered to maintain the household if over one-half of the support of the household is provided by the taxpayer (or, if married, the taxpayer and his or her spouse).

[11] If no one person contributes over half the support of an individual, the taxpayer is treated as meeting the support requirement if: (a) over half the support is received from persons each of whom, but for the fact that he or she did not provide over half such support, could claim the individual as a dependent; (b) the taxpayer contributes over 10 percent of such support; and (c) the other caregivers who provide over 10 percent of the support file written declarations stating that they will not claim the individual as a dependent.

[12] For taxable years beginning in 2006 and 2007, the otherwise applicable personal exemption phase-out is reduced by one-third and for taxable years beginning in 2008 and 2009, the otherwise applicable phase-out is reduced by two-thirds. The personal exemption phaseout is repealed for taxable years beginning after December 31, 2009, and reinstated for taxable years beginning after December 31, 2010.

2010, $2,500 for 2011, and would be equal to the regularly applicable exemption amount for 2012 and thereafter.

A qualified family member would mean an individual with long-term care needs who (1) is the spouse of the taxpayer or a dependent of the taxpayer or the taxpayer's spouse with respect to whom the taxpayer is allowed to claim a personal exemption, and (2) satisfies a residency requirement. In the case of individuals who are a dependent by reason of living in the taxpayer's household for the entire taxable year, the residency requirement would be the same as that under the dependency exemption. In the case of other dependents, the residency requirement would be satisfied if, for more than one half of the taxable year, the individual has as his or her principal place of abode the home of the taxpayer and is a member of the taxpayer's household. As under present law, a taxpayer would be treated as maintaining a household for a period only if the taxpayer (or, if married, the taxpayer and his or her spouse) furnishes more than one-half the cost of maintaining the household for the entire year.

An individual would be considered to have long-term care needs if he or she has been certified by a licensed physician as being unable, for a period of at least 180 consecutive days, to perform at least two activities of daily living ("ADLs")[13] without substantial assistance from another individual due to a loss of functional capacity. Substantial assistance would include both hands-on assistance (that is, the physical assistance of another person without which the individual would be unable to perform the ADL) and stand-by assistance (that is, the presence of another person within arm's reach of the individual that is necessary to prevent, by physical intervention, injury to the individual when performing the ADL).

As an alternative to the two-ADL test described above, an individual would be considered to have long-term care needs if he or she has been certified by a licensed physician as, for at least 180 consecutive days: (1) requiring substantial supervision to be protected from threats to health and safety due to severe cognitive impairment and (2) being unable to perform at least one ADL or to engage in age appropriate activities as determined under regulations prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services.

In all cases, the required certification would have to be made during the 39-1/2 month period ending on the due date (without extensions) for filing the return for the taxable year (or such other period as the Secretary of the Treasury may prescribe).

Married couples would not be entitled to claim the additional personal exemption unless they file a joint return. An individual who is legally separated from his or her spouse would not be considered married. In addition, married individuals who live apart during the last six months of the year would not be considered married if certain requirements are satisfied.

The taxpayer would be required to provide a correct physician identification number (e.g., the Unique Physician Identification Number that is currently required for Medicare billing)

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[13] As under the present-law rules relating to long-term care, ADLs would be defined as eating, toileting, transferring, bathing, dressing, and continence.

for the certifying physician. Failure to provide correct physician identification numbers would be subject to the mathematical error rule. Under that rule, the IRS may summarily assess additional tax due without sending the individual a notice of deficiency and giving the taxpayer an opportunity to petition the Tax Court.

Effective Date

The proposal would be effective for taxable years beginning after December 31, 2002.