

# DEPARTMENT OF TAXATION

## 2012 Fiscal Impact Statement

1. **Patron** Harry R. Purkey

3. **Committee** House Finance

4. **Title** Individual income tax deductions; life, medical, and dental insurance premiums

2. **Bill Number** HB 518

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would allow an income tax deduction equal to the amount an individual age 66 or older with annual earned income of at least \$20,000 pays in annual premiums for a life insurance policy covering such individual or medical or dental insurance for any person for which the individual taxpayer may claim a deduction for such premiums under federal income tax laws.

The deduction would not be allowed for any portion of premiums for which the taxpayer has been reimbursed, has claimed a deduction for federal income tax purposes, or has claimed another Virginia income tax deduction or subtraction.

This deduction would be effective for taxable years beginning on or after January 1, 2012.

6. **Budget amendment necessary:** Yes.

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7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)

### 8. **Fiscal implications:**

#### Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

#### Revenue Impact

This bill would result in an unknown, but potentially significant, revenue loss. The extent of the loss would depend on the number of taxpayers who are age 66 or older with earned income of at least \$20,000, as well as the amount of premiums paid by such individuals.

## 9. Specific agency or political subdivisions affected:

Department of Taxation

## 10. Technical amendment necessary: Yes.

To ensure that a taxpayer does not claim the proposed deduction for the same expenses for which a federal or state income tax credit has been granted, the Department suggests the following technical amendments:

Line 291, after purposes,

Insert: (c) claimed a federal or state income tax credit

Line 292, after or

Strike: (c)

Insert: (d)

## 11. Other comments:

### Federal Deductions for Insurance Premiums

Taxpayers who claim itemized deductions may claim a deduction for medical and dental expenses to the extent that such expenses exceed 7.5 percent of the taxpayer's adjusted gross income ("AGI"). This threshold amount is set to increase to 10 percent of AGI after 2012. Medical insurance premiums that provide reimbursement or indemnity for medical care are included in the definition of "medical expenses" and, accordingly, may be deducted to the extent that all medical expenses exceed the threshold amount.

The federal medical expense deduction may be claimed for expenses paid during the taxable year for the medical care of the taxpayer, his spouse, or a dependent. For purposes of the deduction, a dependent means a dependent for which a personal exemption may be claimed, except that it also includes married dependents and dependents who have their own dependents, and it also eliminates the gross income requirement for qualifying relatives other than qualifying children.

Another deduction is allowed for the insurance costs of self-employed individuals. This deduction is equal to the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, the taxpayer's spouse, the taxpayer's dependents, and any child of the taxpayer who is younger than 27 at the end of the taxable year. This deduction is not allowed to the extent that the amount of the deduction exceeds the taxpayer's earned income, nor can it be claimed if the taxpayer is eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or the taxpayer's spouse or dependents. Additionally, any expenses deducted using this deduction may not be taken into account when determining the amount of the medical expenses deduction.

The self-employed health insurance deduction is taken prior to computing AGI. Because Virginia individual income taxes are based on federal AGI, this means that this federal deduction reduces a taxpayer's Virginia income tax liability.

## Federal Health Coverage Tax Credit

A refundable income tax credit is allowed in an amount equal to 72.5 percent of the amount a taxpayer pays for qualified health insurance coverage for himself or qualifying family members. This credit may only be claimed by eligible trade adjustment allowance ("TAA") recipients, eligible alternative TAA recipients, and eligible Pension Benefit Guaranty Corporation ("PBGC") pension recipients.

## Federal Definition of "Earned Income"

"Earned income" is defined in IRC § 32(c) as wages, salaries, tips, and other employee compensation includible in gross income for the taxable year plus the amount of the taxpayer's net earnings from self-employment for the taxable year, as determined without regard to the federal deduction for self-employment taxes. Certain types of income, such as pension or annuity income, amounts received for services provided while the individual is an inmate at a penal institution, and income of nonresident alien individuals not connected with United States business, are not taken into account when computing earned income.

## Virginia Law

For Virginia income tax purposes, individual taxpayers are permitted to claim a deduction equal to the amount of certain itemized deductions claimed on the federal income tax return. Such deductions include the federal medical expenses deduction.

Virginia law allows an individual taxpayer to claim the Long-Term Care Insurance Tax Credit in an amount equal to 15 percent of the qualified long-term care insurance premiums paid by the taxpayer during the taxable year pursuant to an insurance policy entered into on or after January 1, 2006. To qualify, the premiums must be for long-term care insurance coverage for the taxpayer. Total credits allowed over the life of any policy cannot exceed 15 percent of the amount of premiums paid for the first 12 months of coverage.

Additionally, a taxpayer to claim an income tax deduction equal to the amount an individual pays annually in premiums for long-term health care insurance. This deduction may only be claimed if the individual has not claimed a deduction for federal income tax purposes or the Long-Term Care Insurance Tax Credit.

## Proposal

This bill would allow an income tax deduction equal to the amount an individual age 66 or older with annual earned income of at least \$20,000 pays in annual premiums for a life insurance policy covering such individual or medical or dental insurance for any person for which the individual taxpayer may claim a deduction for such premiums under federal income tax laws.

For purposes of this deduction, "earned income" would be defined by IRC § 32(c), which defines earned income as wages, salaries, tips, and other employee compensation includible in gross income for the taxable year plus the amount of the taxpayer's net

earnings from self-employment for the taxable year, as determined without regard to the federal deduction for self-employment taxes.

The deduction would not be allowed for any portion of premiums for which the taxpayer has been reimbursed, has claimed a deduction for federal income tax purposes, or has claimed another Virginia income tax deduction or subtraction. A technical amendment is suggested to prohibit a taxpayer from claiming the proposed deduction and a federal or state income tax credit for the same premiums.

This deduction would be effective for taxable years beginning on or after January 1, 2012.

#### Similar Legislation

**House Bill 517** would create a similar income tax deduction for life, medical, or dental insurance premiums paid by any individual.

**House Bill 505** and **Senate Bill 341** would increase the amount of qualified premiums that qualify for the Long-Term Care Insurance Tax Credit from 15 percent to 30 percent.

cc : Secretary of Finance

Date: 1/27/2012 KLC  
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