DEPARTMENT OF TAXATION
2016 Fiscal Impact Statement

1. Patron Sam Rasoul

2. Bill Number HB 1035

House of Origin:
X **Introduced**
___ **Substitute**
___ **Engrossed**

Second House:
___ **In Committee**
___ **Substitute**
___ **Enrolled**

3. Committee House Finance

4. Title Income Tax; Elderly Care Savings Trust Accounts

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5. Summary/Purpose:

This bill would establish elderly care savings trust accounts to facilitate the saving of private funds to defray the medical and health-related expenses of the elderly. Individuals would be permitted to claim a subtraction for any income for the taxable year taxed for federal income tax purposes as a capital gain, interest income, or other income that is attributable to the individual's elderly care savings trust account. This bill would also require a Virginia income tax addition for certain losses and distributions related to an elderly care savings trust account.

This bill would also allow a subtraction for any income attributable to a distribution of benefits or a refund from an Achieving a Better Life Experience ("ABLE") savings trust account. The subtraction for any income attributable to a refund would be limited to income attributable to a refund in the event of a beneficiary's death or receipt of a scholarship in the case of an ABLE savings trust account.

This bill would be effective on January 1, 2017. The Virginia income tax additions and subtractions created under this bill would be effective for taxable years beginning on or after January 1, 2017.

6. Budget amendment necessary: No.

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

8. Fiscal implications:

Administrative Costs

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

Revenue Impact

This bill would have an unknown negative General Fund revenue impact, beginning in Fiscal Year 2018. The negative revenue impact would arise because the earnings in elderly care savings trust accounts would be subtracted for the purposed of calculating Virginia taxable income. Unlike college savings trust accounts and ABLE savings trust accounts, these accounts would not be eligible for similar federal tax benefits. Therefore, it is unknown how many of these accounts would be opened and how much would be invested in them.

9. Specific agency or political subdivisions affected:

Department of Taxation
Virginia College Savings Plan

10. Technical amendment necessary: No.

11. Other comments:

Federal Health-Care Tax Preferences

While federal tax law has no provision comparable to the elderly care savings trust accounts proposed in this bill, taxpayers may receive the following healthcare-related tax preferences:

Medical Expense Deduction

A taxpayer who elects to itemize can deduct the amount by which certain unreimbursed medical and dental expenses paid during the year for himself, his spouse, and his dependents exceed 10 percent of his adjusted gross income. The income restriction is reduced to 7.5 percent if the taxpayer or his spouse is over age 65 before the end of the taxable year. Deductible medical expenses are amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Federal law also allows a deduction for transportation primarily for and essential to medical care; qualified long-term care services; insurance covering medical care; and, in the case of a qualified long-term care insurance contract, eligible long-term care premiums.

Health Savings Accounts

A health savings account (HSA) is a tax-exempt trust or custodial account that can be set up with a qualified HSA trustee to pay or reimburse certain medical expenses. To be an eligible individual and qualify for an HSA, a taxpayer must be covered under a high deductible health plan (HDHP) on the first day of the month; generally must have no other health coverage; must not be enrolled in Medicare; and cannot be claimed as a dependent on someone else's tax return.

No permission or authorization from the Internal Revenue Service is necessary to establish an HSA. A taxpayer sets up an HSA with a trustee. A qualified HSA trustee can be a bank, an insurance company, or anyone already approved by the IRS to be a trustee of individual retirement arrangements (“IRAs”) or Archer medical savings accounts. The HSA can be established through a trustee that is different from your health plan provider.

Medicare Advantage Medical Savings Accounts

A Medicare Advantage medical savings account (“MSA”) is an account designated by Medicare to be used solely to pay the qualified medical expenses of the account holder. To be eligible for a Medicare Advantage MSA, a taxpayer must be enrolled in Medicare and have a high deductible health plan (“HDHP”) that meets the Medicare guidelines.

A Medicare Advantage MSA is a tax-exempt trust or custodial savings account that must be set up with a financial institution (such as a bank or an insurance company) in which the Medicare program can deposit money for qualified medical expenses. The money in an account is not taxed if it is used for qualified medical expenses, and it may earn interest or dividends.

An HDHP is a special health insurance policy that has a high deductible. Taxpayers may choose the policy they want to use as part of their Medicare Advantage MSA plan. However, the policy must be approved by the Medicare program.

<u>Virginia Health-Care Tax Preferences</u>

While Virginia tax law has no provision comparable to the elderly care savings trust accounts proposed in this bill, taxpayers may receive the following health care-related tax preferences:

Deduction for Certain Premiums Paid for Long-term Health Care Insurance

A taxpayer may deduct the amount paid annually in premiums for long-term health care insurance. However, no such deduction for long-term health care insurance premiums paid by a taxpayer during the taxable year is allowed if the taxpayer has claimed a federal income tax deduction for such taxable year for long-term health care insurance premiums paid by him.

Prepaid Funeral, Medical, and Dental Insurance Premiums

Taxpayers may deduct the amount paid annually in premiums for a prepaid funeral insurance policy covering the individual or a medical or dental insurance for any person for whom individual tax filers may claim a deduction for such premiums under federal income tax laws. To be eligible for this deduction, the taxpayer must be an individual age 66 or older with earned income of at least $20,000 for the year and federal adjusted gross income not in excess of $30,000 for the year. The deduction is not allowed to the extent that any portion of such premiums paid for which the taxpayer has been reimbursed or has claimed a federal or state tax deduction, subtraction, or credit.

Virginia Legislation Regarding the Federal Achieving Better Life Experiences Act

During its 2015 Session, the General Assembly enacted House Bill 2306 (Chapter 311) and Senate Bill 1404 (Chapter 227), which established a program for Achieving a Better Life Experience ("ABLE") savings trust accounts to facilitate the saving of private funds to pay the qualified disability expenses of certain disabled qualified beneficiaries. A "qualified beneficiary" or "beneficiary" is defined to include a beneficiary of a savings trust account.

Under the federal Achieving a Better Life Experience Act of 2014, Congress authorized states to establish ABLE savings trust accounts to assist individuals and families in saving for education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, and other expenses of individuals who were disabled or blind prior to the age of 26. These Acts allow individuals to establish ABLE savings trust accounts in Virginia. The Virginia College Savings Plan is the designated state agency that will administer ABLE savings trust accounts.

Under federal law, earnings on contributions to ABLE savings trust accounts are exempt from the federal income tax. Because Virginia conforms to the federal income tax treatment, pursuant to Chapters 1 and 61 such earnings are also exempt from Virginia income taxation.

Proposed Legislation

Elderly Savings Trust Accounts

This bill would establish elderly care savings trust accounts to facilitate the saving of private funds to defray the medical and health-related expenses of the elderly. Such accounts would be administered by the Virginia College Savings Plan.

An "elderly care savings trust account" would be defined as an account established to assist individuals and families to save private funds to help defray the cost of medical care for the elderly, with such account used to apply distributions for qualified medical care expenses for qualified beneficiaries of the account.

"Medical care" would mean the same as such term is defined or described under federal law. Federal law defines "medical care" as amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body. Federal law also defines "medical care" to include:

- Transportation primarily for and essential to medical care;
- Qualified long-term care services;
- Insurance covering medical care; and
- In the case of a qualified long-term care insurance contract, eligible long-term care premiums.

"Medical care" would also include amounts paid for a prescribed drug or insulin.

The Board of the Virginia College Savings Plan would be required to develop and implement programs for contributions to elderly care savings trust accounts established on behalf of a qualified beneficiary in order to apply distributions from the account toward such qualified beneficiary's medical care. Each elderly care savings trust agreement would be required to include the following terms and provisions:

- A provision limiting a qualified beneficiary to one elderly care savings trust account;
- A requirement that the qualified beneficiary be the owner of the elderly care savings trust account;
- A requirement that the qualified beneficiary be at least 45 years old;
- A provision restricting account distributions for medical care (i) to qualified beneficiaries who are at least 60 years old and (ii) for expenses or costs to the extent that the same are not paid or reimbursed by or through a flexible spending plan, health savings plan, or other pre-tax program, not claimed as a deduction or subtraction for federal or Virginia income tax purposes, and not claimed as an income tax credit for federal or Virginia income tax purposes;
- A requirement that all contributions to elderly care savings trust accounts be made in cash;
- A maximum annual contribution and a maximum total contribution that can be made to an elderly care savings trust account;
- A minimum annual contribution to elderly care savings trust accounts, which shall be determined through consultation with the Commissioner of the Department for Aging and Rehabilitative Services;
- A separate accounting for each designated beneficiary;
- Provisions for withdrawals, refunds, transfers, return of excess contributions, and penalties;
- The name, address, and date of birth of the qualified beneficiary on whose behalf the savings trust account is opened;
- Terms and conditions for a substitution for the qualified beneficiary originally named;
- Terms and conditions for termination of the account, including any refunds, withdrawals, transfers, applicable penalties, and the name of the person or persons entitled to terminate the account;
- All other rights and obligations of the qualified beneficiary and the Plan; and
- Any other terms and conditions that the Board deems necessary or appropriate.

The maximum annual contribution would apply to the aggregate of all contributions made during the year to the elderly care savings trust account regardless of the source of the contribution and would be equal to the maximum annual contribution allowed for the same year to an ABLE savings trust account.

Virginia Income Tax Subtraction

This bill would allow a subtraction for any income for the taxable year taxed for federal income tax purposes as a capital gain, interest income, or other income that is attributable to the individual's elderly care savings trust account.

Virginia Income Tax Additions

This bill would also require a Virginia income tax addition for certain losses and distributions related to an elderly care savings trust account. Specifically, the bill would require an addition to the taxpayer's federal adjusted gross income for the following:

- Any loss for the taxable year that was deducted as a capital loss for federal income tax purposes by an account owner attributable to such person's elderly care savings trust account.
- Any amount that is income attributable to a distribution of contributions made during the taxable year from an elderly care savings trust account when such distribution is on account of annual contributions to an elderly care savings trust account exceeding the allowable maximum annual contribution or total contributions to an elderly care savings trust account exceeding the allowable maximum total contribution. Such income would be computed in the same manner that income is determined for excess contributions to an ABLE savings trust account.
- Any distribution from an elderly care savings trust account during the taxable year that is in excess of the qualified medical care expenses and medical care costs for such year of the qualified beneficiary of the account. The amount added to federal adjusted gross income would be computed in the same manner that distributions from ABLE savings trust accounts in excess of qualified disability expenses are included in gross income under federal law. This addition would generally not apply to any amount paid or distributed from an elderly care savings trust account to the extent that the amount received is paid, not later than the 60th day after the date of such payment or distribution, into another elderly care savings trust account for the benefit of the same qualified beneficiary or a qualified beneficiary who is a member of the family of the former beneficiary or to any change during the taxable year in the qualified beneficiary of an interest in an elderly care savings trust account if the new beneficiary is a qualified beneficiary and a member of the family of the former beneficiary. "Member of the family" and "qualified disability expenses" would mean the same as such terms are defined or described under federal law.

Other Provisions

This bill would make several technical changes. This bill would re-define the term "savings trust account" so that it includes an elderly care savings trust account. This bill would include, as one of the purposes of the existence of Virginia College Savings Plan, to help defray qualified expenses of individuals with disabilities, and to help defray the medical expenses of the elderly. The Board of the Virginia College Savings Plan would be given the authority to administer to develop and implement programs for contributions to elderly care savings trust accounts established pursuant to this chapter on behalf of a qualified beneficiary in order to apply distributions from the account toward such qualified beneficiary's medical care.

This bill would also allow a subtraction for any income attributable to a distribution of benefits or a refund from an ABLE savings trust account. The subtraction for any income attributable to a refund would be limited to income attributable to a refund in the event of a beneficiary's death or receipt of a scholarship in the case of an ABLE savings trust account.

This bill would be effective on January 1, 2017. The Virginia income tax additions and subtractions created under this bill would be effective for taxable years beginning on or after January 1, 2017.

Similar Legislation

House Bill 1103 would exclude contributions to and distributions from ABLE savings trust accounts when determining whether an individual qualifies for state means-tested assistance and benefits.

cc : Secretary of Finance

Date: 1/23/2016 JJS
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