

**NORTH CAROLINA GENERAL ASSEMBLY**

**LEGISLATIVE FISCAL NOTE**

**BILL NUMBER:** SB 971 (First Edition)

**SHORT TITLE:** Self-Employed Health Insurance Deduction

**SPONSOR(S):** Senator Reeves

<b>FISCAL IMPACT</b>					
	<b>Yes (X)</b>	<b>No ( )</b>	<b>No Estimate Available ( )</b>		
	<b>(\$Millions)</b>				
	<b><u>FY 1997-98</u></b>	<b><u>FY 1998-99</u></b>	<b><u>FY 1999-00</u></b>	<b><u>FY 2000-01</u></b>	<b><u>FY 2001-02</u></b>
<b>REVENUES</b>					
General Fund	(\$15.9)	(\$15.7)	(\$16.9)	(\$18.1)	(\$19.2)
<b>EXPENDITURES</b>					
General Fund	see <b>ASSUMPTIONS AND METHODOLOGY</b>				
<b>PRINCIPAL DEPARTMENT(S) &amp; PROGRAM(S) AFFECTED:</b> Department of Revenue					
<b>EFFECTIVE DATE:</b> This act is effective for taxable years beginning on or after January 1, 1997.					

**BILL SUMMARY:** This act allows a self-employed individual to deduct from state income taxes that portion of health insurance premiums not allowed as a deduction from federal taxable income.

**BACKGROUND:** Prior to this year, self-employed individuals could deduct from their federal income tax 30% of the amount paid for health insurance for themselves and their dependents. In 1996, Congress passed the Health Insurance Portability and Accountability Bill (HR 3103) that included an increase in the deduction according to the following schedule:

1997	40%
1998- 2002	45%
2003	50%
2004	60%
2005	70%
2006	80%

**ASSUMPTIONS AND METHODOLOGY:**

REVENUE

The Department of Revenue Tax Research Section estimates that 80,000 North Carolinians use the federal income tax deduction for self-employed individuals. The type of policy purchased by the self-employed was determined by the Employee Benefit Research Institute in a November 1996 report (EBRI Issue Brief Number 179). Using March 1996 Current Population Survey data from the U.S. Bureau of the Census, the Institute found the following distribution of policy holders:

Employee Only	32.5%
Employee & Spouse	15.5%
Family	52.0%

When these percentages are applied to the 80,000 North Carolina taxpayers, the breakdown in policies is as follows:

Employee Only	26,000
Employee & Spouse	12,400
Family	41,600

Premium amounts were provided by the state's Health Plan Purchasing Alliance Board. Companies such as Blue Cross Blue Shield and Employers Life Insurance Company of Wausau quoted premiums based on a policy that was an indemnity plan type, with a \$500 deductible, and a 80/20 co-insurance payment. For this fiscal note, the average quote used is as follows:

Employee Only	\$148.72/month
Employee & Spouse	\$388.21/month
Family	\$547.54/month

In future years, these premium amounts are increased as follows:

FY 1998-99	8.0%
FY 1999-00	7.5%
FY 2000-01	7.0%
FY 2001-02	6.5%

These rate increases were suggested by Aon Consultants of Atlanta, who serve as actuarial consultants to the State Employees Health Plan. According to Senior Fiscal Analyst Sam Byrd of the General Assembly's Fiscal Research Division, 50 - 60% of the inflation rate is based on medical inflation and the remainder on utilization increases.

In FY 1997-98, the federal tax deduction will be 40%, thus the state deduction will be 60%. In years 1998-99 through 2001-02, the federal deduction is 45% and the state deduction is 55%. The tax loss from the deduction is based on a 7% tax rate.

**1997-98**

	<u>Monthly Premium</u>	<u>Annual Premium</u>	<u>Number of Policies</u>	<u>Total Premiums</u>	<u>60% State Deduction</u>	<u>Tax Loss at 7% Rate</u>
Employee Only	148.72	1,784.64	26,000	46,400,640	27,840,384	1,948,827
Employee & Spouse	388.21	4,658.52	12,400	57,765,648	34,659,389	2,426,157
Family	547.54	6,570.48	41,600	273,331,968	163,999,181	11,479,943
			80,000	\$377,498,256	\$226,498,954	\$15,854,927

### 1998-99

	<u>Monthly Premium</u>	<u>Annual Premium</u>	<u>Number of Policies</u>	<u>Total Premiums</u>	<u>55% State Deduction</u>	<u>Tax Loss at 7% Rate</u>
Employee Only	160.62	1,927.41	26,000	50,112,691	27,561,980	1,929,339
Employee & Spouse	419.27	5,031.20	12,400	62,386,900	34,312,795	2,401,896
Family	591.34	7,096.12	41,600	295,198,525	162,359,189	11,365,143
			80,000	\$407,698,116	\$224,233,964	\$15,696,377

### 1999-00

	<u>Monthly Premium</u>	<u>Annual Premium</u>	<u>Number of Policies</u>	<u>Total Premiums</u>	<u>55% State Deduction</u>	<u>Tax Loss at 7% Rate</u>
Employee Only	172.66	2,071.97	26,000	53,871,143	29,629,129	2,074,039
Employee & Spouse	450.71	5,408.54	12,400	67,065,917	36,886,255	2,582,038
Family	635.69	7,628.33	41,600	317,338,415	174,536,128	12,217,529
			80,000	\$438,275,475	\$241,051,511	\$16,873,606

### 2000-01

	<u>Monthly Premium</u>	<u>Annual Premium</u>	<u>Number of Policies</u>	<u>Total Premiums</u>	<u>55% State Deduction</u>	<u>Tax Loss at 7% Rate</u>
Employee Only	184.75	2,217.00	26,000	57,642,123	31,703,168	2,219,222
Employee & Spouse	482.26	5,787.14	12,400	71,760,532	39,468,292	2,762,780
Family	680.19	8,162.31	41,600	339,552,104	186,753,657	13,072,756
			80,000	\$468,954,758	\$257,925,117	\$18,054,758

### 2001-02

	<u>Monthly Premium</u>	<u>Annual Premium</u>	<u>Number of Policies</u>	<u>Total Premiums</u>	<u>55% State Deduction</u>	<u>Tax Loss at 7% Rate</u>
Employee Only	196.76	2,361.11	26,000	61,388,861	33,763,874	2,363,471
Employee & Spouse	513.61	6,163.30	12,400	76,424,966	42,033,731	2,942,361
Family	724.41	8,692.86	41,600	361,622,991	198,892,645	13,922,485
			80,000	\$499,436,818	\$274,690,250	\$19,228,317

NOTE: Under the current federal law, the 60 % of health insurance premiums not deductible under Code section 162(l) is deductible as a medical expense under Code section 213(a) if the

taxpayer itemizes deductions. Medical expenses must exceed 7.5% of adjusted gross income to be eligible as a deduction. SB 971 does not eliminate this deduction for the state income tax, thus giving the taxpayer a double benefit on health premium payments.

**EXPENDITURES**

If enacted, the Department of Revenue will incur one-time programming costs and annual data entry costs. To implement SB 971, the Department requests an appropriation of \$32,480 in FY 1997-98 and \$4,320 for the following years.

**TECHNICAL CONSIDERATIONS:** The reference to Internal Revenue Code sections 162(e) and 162(e)(B) should be changed to 162(l) and 162(l)(B).

**FISCAL RESEARCH DIVISION**

**733-4910**

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**DATE:** May 22, 1997



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