



Legislative Fiscal Bureau

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TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 6 and Senate Bill 37: Individual Income Tax Deductions for Certain Medical Insurance Premiums

Assembly Bill 6 and Senate Bill 37 are companion bills that would provide deductions from the individual income tax for certain medical insurance premiums. Assembly Bill 6 was introduced on January 18, 2005, and referred to the Joint Committee on Finance and the Joint Survey Committee on Tax Exemptions, which found the bill to be good public policy. Assembly Substitute Amendment 1 to AB 6 was introduced on March 23, 2005.

Senate Bill 37 was introduced on February 2, 2005, and referred to the Senate Committee on Job Creation, Economic Development and Consumer Affairs. The bill was withdrawn from that committee and referred to the Joint Survey Committee on Tax Exemptions on February 9, 2005. The Joint Survey Committee found SB 37 be good public policy, and re-referred the bill to the Senate Committee on Job Creation, Economic Development, and Consumer Affairs on February 24, 2005. The bill was subsequently referred to the Joint Committee on Finance. Senate Substitute Amendment 1 to SB 37, which is a companion to ASA 1 to AB 6, was introduced on March 23, 2005.

CURRENT LAW

Under current law, there are two state individual income tax deductions for medical care insurance premiums. The first deduction is for medical care insurance paid for by self-employed individuals. Such individuals may deduct from income 100% of medical care insurance premiums paid that do not exceed net earnings from a trade or business. The second income tax deduction pertains to premiums paid by an employee whose employer did not contribute anything toward the cost of the medical care insurance. In such cases, Wisconsin law permits a subtraction of 50% of

the premiums paid by the employee. As with the deduction for self-employed individuals, the statutes specify that the amounts deductible under these provisions may not exceed net earnings from a trade or business. DOR has interpreted this provision to mean wages, salaries, tips, and other employee compensation. For purposes of these deductions, "medical care insurance" means a medical care insurance policy that covers a taxpayer, the taxpayer's spouse, and the taxpayer's dependents and provides surgical, medical, hospital, major medical, or other health service coverage. In addition, the deduction is limited to the person's aggregate net earnings from a trade or business that are taxable by this state.

Currently, certain medical care insurance premiums are also eligible to be included in the calculation of the state's itemized deduction credit. The itemized deduction credit is equal to 5% of the excess of allowable itemized deductions over the sliding scale standard deduction. Medical expenses that conform to those permitted as federal itemized deductions, which include medical expenses exceeding 7.5% of federal adjusted gross income, are generally allowable for calculating the state itemized deduction credit. However, medical care insurance premiums that are allowable federal itemized deductions but are subtracted from Wisconsin income (under one of the income tax deductions described above) are disallowed for purposes of the state's itemized deduction credit.

SUMMARY OF BILLS

AB 6 and SB 37 are companion bills that would expand the current law deduction for medical care insurance premiums paid by an employee whose employer does not contribute toward the cost of the insurance from 50% to 100% of the premiums paid. In addition, the bills would create a 100% deduction for medical care insurance premiums paid by an individual for a policy covering the individual and the individual's spouse and dependents if the individual has no employer. In each case, the deduction would also be limited to the individual's aggregate wages, salary, tips, unearned income, and net earnings from a trade or business (as compared to "net earnings from a trade or business," under current law). The deduction for premiums paid by an individual with no employer would not apply if the individual were self-employed (in which case, the individual could claim the deduction under current law described above). The proposed tax deductions would first apply to taxable years beginning on January 1, 2005. Medical insurance premiums deducted under these provisions would be disallowed for purposes of the state's itemized deduction credit.

An estimate of the fiscal effect of the bills can be made using information from the 2003 Wisconsin tax sample, which has data from over 20,000 tax returns, weighted to reflect all taxpayers in 2003. In addition, it is necessary to make assumptions about the average medical care insurance premiums paid by retired persons, the average medical care insurance premiums paid by non-elderly individuals without an employer and without self-employment income, and the percentage of non-elderly individuals without an employer or self-employment income that purchase medical care insurance. These assumptions were made using information from the Kaiser Family Foundation and the Employee Benefits Research Institute.

FISCAL EFFECT OF BILLS

Based on these sources, it is estimated that the bills would reduce individual income tax collections by \$18.0 million in 2005-06 and by \$19.5 million in 2006-07. Of these amounts, it is projected that approximately \$2.0 million in each year would be from the increase in the deduction for medical care insurance premiums paid by an individual whose employer does not contribute toward the individual's medical care insurance from 50% to 100%. The remaining amounts, \$16.0 million in 2005-06 and \$17.5 million in 2006-07, are the estimated costs of the deduction for medical care insurance premiums paid by individuals without an employer or self-employment income.

SUMMARY OF SUBSTITUTE AMENDMENTS

Under the proposed substitute amendments, the increase in the deduction for medical care insurance premiums paid by an individual whose employer does not contribute toward the individual's medical care insurance from 50% to 100% would take effect for tax year 2005, as provided under the bills. However, the proposed deduction for medical care insurance premiums paid by an individual with no employer and no self-employment income would be phased in over a three-year period, starting with tax year 2006. Under these provisions, 33.4% of the cost of such premiums would be deductible for tax year 2006, 66.7% of such premiums would be deductible for tax year 2007, and 100% of such premiums would be deductible for tax years 2008 and thereafter.

FISCAL EFFECT OF SUBSTITUTE AMENDMENTS

It is estimated that the substitute amendments would reduce state individual income tax collections by \$2.0 million in 2005-06 and by \$7.8 million in 2006-07, for a biennial total of \$9.8 million. In addition, state tax collections would be reduced by an estimated \$13.7 million in 2007-08 and \$19.5 million in 2008-09 and annually thereafter. The estimates for 2007-08 and beyond are provided in 2006-07 dollars.

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