

Pitfalls of Tax Incentives For Long-Term Care

Commentary

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Included in the health care proposals announced by the White House recently and highlighted in the President's state of the union address is a \$3,000 income-related, nonrefundable tax credit for severely disabled persons and families helping to care for them. The plan stands a good chance of being enacted, reflecting a growing consensus that more needs to be done to ease the burdens of long-term care. While this attention is welcome, the use of the tax code to solve long term care problems raises issues of fairness and effectiveness.

This is not the first time Congress has debated the use of tax incentives for long-term care. The President proposed a \$1,000 tax credit last year, and Congress included a modified version of his proposal and tax deductions to encourage the purchase of private long-term care insurance in its 1999 tax bill, which was vetoed. The tax bill provided for so-called "above the line" tax deductions for private long-term care insurance, so all taxpayers could have used the tax incentive, whether or not (as under current law) they itemize and have large out-of-pocket medical expenses.

While these proposals differ, all use the tax code to address long-term care problems. The use of a common strategy reflects Congressional unwillingness to increase public spending for Medicare, Medicaid, the Older Americans Act, and other direct service programs. This approach to reform has many pitfalls.

First, tax incentives benefit mainly middle- and upper-income taxpayers, offering little relief for lower income individuals and none for those too poor to pay taxes. Since most Social Security payments are excluded from federal income taxes, only half of older Americans pay any federal income tax at all. Also, two-thirds of younger people with severe disabilities do not have jobs, so few pay taxes. Making the tax incentives refundable would solve this problem, but would be very costly.

The tax deductions for private long-term care insurance also will benefit mostly upper-income people. A \$1,000 tax deduction for a person in the 15 percent bracket is worth \$150, compared to \$396 for someone in the 39.6 percent tax bracket.

On the other hand, tax incentives financially reward individuals who act in the way that society wants them to act. The President's tax incentive gives a boost to family caregivers who care for severely disabled relatives. Since informal care is the backbone of long-term care, rewarding those who take on this burden makes good sense. A similar argument could be made for helping people who prepare for their own future long term care needs by purchasing private insurance.

Second, these two tax incentives are too small to make much difference in how people act. Few children decide whether or not to put their disabled mother in a nursing home based on whether or not they receive a tax credit. Moreover, the average tax benefit is likely to be \$1,500 for those eligible, a sum that cannot buy much long-term care. In contrast, President Clinton's 1994 long-term care proposal, which would have provided home care for the same population, was budgeted at \$10,000 per person. A general income supplement for people with disabilities and their families is a good idea but it does not constitute a program to pay for long-term care services.

Similarly, since high-quality private long-term care insurance policies cost roughly \$2,400 a year if purchased at age 65, a \$360 tax benefit (assuming full deductibility at the 15 percent tax bracket) only reduces the price to \$2,040—still far more than the vast majority of older persons can afford.

Third, although individuals would receive only small benefits, so many people would qualify for the proposed tax credit that the annual costs would be fairly large, about \$3 billion for the President's proposal and \$1 billion for the private long-term care insurance measure. Even in Washington, \$1-3 billion a year is real money.

In addition, the tax benefit would mainly certify existing good behavior, rather than change it. Most taxpayers who would benefit from the tax incentives have already purchased private long-term care insurance or are already caring for a disabled relative. Thus, the cost for every person whose behavior is actually changed is very high. This targeting problem also characterizes many universal benefit programs, such as proposals to provide subsidies for health insurance, but such programs do not limit participation by low-income people, as do these proposals.

The bottom line: tax incentives symbolically reward actions that society values, but only tax breaks much larger than those commonly proposed are likely to change behavior. Despite this, Congress appears willing to debate tax incentives with significant revenue losses, but not increases in direct spending programs. Congress should rethink its antipathy to direct spending programs because they do a better job of targeting people in need and are more efficient in allocating resources. Resistance to service programs may change after the 2000 election, but it might not. In the meantime, the question is whether these tax proposals add enough money to the long-term care pot to warrant their passage, even if they are second-best approaches to reform.

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