Long-Term Services & Supports Feasibility Policy Note

Implications of Using Tax Incentives to Increase Long-Term Care Insurance Coverage

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1. Introduction

As the older population in the United States increases, more people experience functional and cognitive limitations that affect activities of daily living (ADLs), such as bathing, eating, dressing, and using the toilet; instrumental activities of daily living (IADLs), which include shopping, cooking, and housework; or both. Caregiving responsibilities fall upon the loved ones of individuals who need help with ADLs and IADLs. This dependence on informal caregiving increases the need for professional long-term care, also known as long-term services and supports.

In addition to being mentally and physically draining, caregiving involves considerable financial burden for the caregiver and recipient. Many families with an older, disabled loved one face the question of how to pay for long-term care. Most people cannot afford the high costs of private long-term care insurance and those who qualify for public assistance programs become impoverished attempting to pay for long-term care (Johnson and Uccello 2005; Johnson 2008; Baer and O'Brien 2010). Many individuals suffer without access to long-term care services (Weiner et al. 2013). As of 2012, just 7 to 9 million Americans owned private long-term care insurance (AHIP 2012).

Policymakers have looked to use tax incentives to promote the purchase of private long-term care insurance in an effort to reduce the population without coverage. Long-term care insurance is not intended to cover illnesses or conditions but rather to help pay for institutional care or professional therapy which includes skilled care such as personal, household, and custodial services provided in a nursing home, assisted living facility, or at home. Most long-term care recipients live alone at home or with their families (Johnson and Uccello 2005). Drawbacks to purchasing long-term care insurance, as well as issues with the private market, are cause for concern over the use of tax incentives to purchase coverage. This paper examines the private long-term care insurance market, whether tax incentives increase coverage overall, and concludes with a recommendation from the Hawaii Long-Term Care Commission (HLTCC).

2. The Private Long-Term Care Insurance Market

Problems associated with the market for private long-term care insurance are implicated in the use of tax incentives. It is important to understand how the high price and relative exclusiveness of long-term care insurance impacts coverage rates, which affect the impact of tax incentives. Most low- and moderate- income people cannot afford to pay private long-term care insurance premiums out-of-pocket and thus coverage is largely available to a limited group of wealthy individuals (Goda 2011). In addition, typical long-term care insurance policies are priced higher than the worth of expected benefits and provide only limited benefits when total expenditure risk is taken into account (Brown and Finkelstein 2007).

It can be difficult to obtain private long-term care insurance. Though age and health of the policyholder determine the price of the policy, premiums increase with age and are higher with worse health of the purchasing individual (Johnson and Uccello 2005; Cramer and Jenson 2006). If insurance companies offer coverage to individuals in poor health coverage, which they are reluctant to do for fear that benefit costs will outweigh revenue, the premiums are often priced so high that potential policyholders cannot afford them (Johnson and Uccello 2005). The challenges of gaining coverage and unaffordability of available policies make accessing long-term care services difficult if not impossible for many individuals, especially those who need assistance with ADLs and IADLs. Since individuals cannot afford to pay the high premium prices for long-term care insurance out-of-pocket, many policyholders lapse, or stop paying the premiums on their policies (HLTCC 2012).

Not only are private long-term care insurance policies expensive at the time of purchase, so much so that most people cannot afford to pay out-of-pocket, but there is also a risk that premiums can increase after the initial purchase. It is not uncommon for insurance companies to implement premium rate increases on entire “books of business,” or large groups of policyholders at a time, which can lead policyholders to lapse (Johnson and Uccello 2005). These problems demonstrate the unpredictable nature of maintaining a private long-term care insurance policy.

3. Do Tax Incentives Increase Coverage?

Given that tax incentives cannot protect against the probability of premium rate increase and other problems that cause policyholders to lapse, the long-term benefit of their use is unknown (Merlis 2003). Lapse rates of private long-term care insurance call into question the reliability and long-term impact of the use of tax incentives. Many policies do not contain nonforfeiture benefits, which would guarantee partial benefits to those who lapse (Johnson and Uccello 2005). Thus, policyholders who lapse receive nothing in exchange for the premiums they paid over the course of their policy or prior to lapsing (Johnson and Uccello 2005). In light of the fact that many private long-term care insurance policies do not include lapse protection, the use of tax incentives poses a risk of wasted benefits among those who lapse their policies (Merlis 2003).

Problems associated with the private long-term care insurance market affect the reliability and distort the purpose of tax incentives to increase coverage of long-term care. Private insurance coverage for long-term care is expensive and can be unavailable to those most in need (Johnson and Uccello 2005). The population who would benefit from tax incentives would continue to be limited to wealthier individuals (Goda 2010; HLTCC 2012). Tax incentives would be used to purchase private policies that lack inflation protection and are not protected against the probability of premium rate increase, which contribute to lapse rates and lead to potentially wasted benefits. Thus, individuals who qualify for tax incentives might face considerable burden resulting from the policies they use them to purchase (Johnson and Park 2011). In addition, substantial tax loss results from the use of tax incentives, which should also be considered (Goda 2011; HLTCC 2012). Overall, the disadvantages associated with the use of tax incentives for the purchase of long-term care insurance outweigh any potential benefits.

According to previous research, the impact of tax incentives is diminished by the fact that they are typically made available to higher income, asset-rich individuals (Goda 2011; HTLCC 2012). Tax incentives are not available to older individuals who do not pay federal taxes because some or all of their Social Security benefits are not taxed (HLTCC 2012). Most low- and moderate- income people would not be able to afford long-term care insurance premiums out-of-pocket over the course of a year and thus would not be able to claim a tax credit at the end of the year (HLTCC 2012). Higher income, wealthy individuals are most likely to qualify for tax incentives, which limits the effectiveness of tax credits and leads to increasing inequality of long-term care coverage and use of services (Goda 2011; HLTCC 2012). Essentially, tax incentives would benefit those who already bought or could have purchased private insurance without the tax incentive the most (Goda 2010; HLTCC 2012). Thus, tax incentives would not substantially increase coverage rates of long-term care insurance.

4. Conclusion

The Hawaii Long-Term Care Commission (HLTCC) argued against the use of tax incentives for the purchase of long-term care insurance for three main reasons: (1) tax incentives do not significantly increase rates of long-term care insurance; (3) tax incentives mostly benefit higher income individuals compared to low and moderate-income people, which detracts from their overall effect; (3) the tax loss after use of tax incentives would result other tax increases or cuts in other state spending.

In conclusion, tax incentives for long-term care insurance may not have a long-term benefit at all for the general public (Merlis 2003). The slight impact of tax incentives on coverage rates is largely concentrated among wealthier populations (Goda 2012). Only “extremely large” tax incentives would have a significant impact on coverage rates (HLTCC 2012: 38). Based on previous research and a recommendation by the HLTCC, it can be determined that the use of tax incentives for purchasing long-term care insurance does not solve the problem of increasing need for formal long-term care services and supports.

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