Oregon Center For Public Policy

Issue Brief

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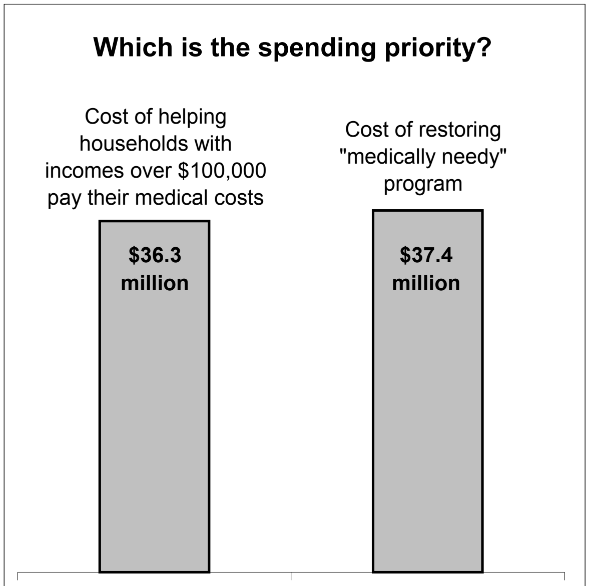
Robin Hood's Medical Plan:
Changing Oregon's Priorities to Restore the Medically Needy Program

When legislators develop the state budget, they scrutinize the spending of state agencies and hold hearings in an effort to ensure that government programs and services are efficient, effective, and meet the public's priorities. If revenues are expected to fall short of what is required to fund existing programs, legislators either raise revenue or decide which programs should be reduced or eliminated. Whether they choose to keep or eliminate programs, legislators have to take affirmative action in this process.

At the same time, Oregon spends millions of dollars through the tax code. Unlike agency budgets, most of this spending receives little serious oversight. All but a handful of these "tax expenditures" continue automatically into the next budget period without any action by the Legislature. Tax expenditures are not accounted for in agency budgets, but they are government spending all the same. They are catalogued and described in the biennial Tax Expenditure Report that is issued at the same time the Governor's Recommended Budget is released.[1]



Source: OCPP analysis of IRS, Oregon Dept. of Revenue data; 2003-05 Governor's Revised Budget.

A number of tax breaks provide government assistance to well-off Oregonians. At a time when vulnerable Oregonians – children, disabled people, low-income seniors, and other poor families – are suffering the consequences of losing vital services as the result of state budget cuts, tax breaks for the wealthy deserve more scrutiny.

How the state helps Oregonians with medical care provides a good example of the need for additional scrutiny. Over the next two years, Oregon will provide tax breaks worth about $36 million to households earning over $100,000, to help cover the costs of medical and dental care. This $36 million will be spent through two related tax breaks. At the same time, state legislators are eliminating the Medically Needy program, which provides prescription drugs for low-income seniors and disabled Oregonians. Maintaining this program over the next two years would cost $37.4 million, roughly the same as the cost of the medical tax breaks that support well-off Oregonians. Which should be Oregon's spending priority?

The Medically Needy program

The Medically Needy program covered prescription drug coverage and mental health services for elderly and disabled Oregonians ineligible for assistance through the Oregon Health Plan. The program also provided Medicaid benefits for disabled children. When the program was eliminated on February 1, 2003 after the failure of Measure 28, 8,777 Oregonians lost coverage. In response to protests by advocates and program recipients, the 2003 Legislative Assembly subsequently restored prescription drug coverage for some Oregonians with HIV/AIDS or with organ transplants, but only for the final three months of the current budget cycle.[2]

On July 1, 2003, even the small remaining program for Oregonians with HIV/AIDS or organ transplants will be eliminated. Both Governor Kulongoski and the co-chairs of the Joint Committee on Ways and Means of the Legislative Assembly have proposed this elimination, which they estimate will save $37.4 million.[3]

Helping the wealthy with medical and dental care

The Federal-State Tax Deduction

Since 1942, the federal government has offered a tax break to all Americans whose out-of-pocket medical costs exceed a certain percentage of their income. Today, medical and dental costs that exceed 7.5 percent of a taxpayer's adjusted gross income are deductible on their federal tax return, if the taxpayer itemizes deductions. Taxpayers are eligible for this deduction regardless of income level or age. Nearly all medical and dental procedures qualify as deductible expenses, including the costs of contact lenses, treatment for alcohol addiction, acupuncture, and certain weight loss programs.

The federal deduction is designed to help with high out-of-pocket medical costs relative to income. Since there is no limit on the medical expenses that are deductible, the federal tax savings resulting from this deduction may be considerable for some taxpayers. Moreover, taxpayers taking the federal deduction also get a break on their Oregon income taxes, because federal tax deductions reduce the amount of income that is taxable by Oregon.

A total of 4,208 Oregonians with adjusted gross incomes over $100,000 took this deduction on their federal returns in 2001 (Table 1). These wealthy beneficiaries of the federal tax break saved about $1,006 on average in state income taxes thanks to the federal deduction.

The Oregon Medical Deduction for the Elderly

In 1991, Oregon created an additional medical care tax break for taxpayers aged 62 and over. Today, these elderly Oregonians may deduct all medical and dental expenses that are allowed under the federal tax break, including contact lenses, treatment for alcohol addiction, acupuncture, and certain weight loss programs. Designed to interact with the federal deduction that covers expenses over 7.5 percent of income, the special Oregon deduction for elderly Oregonians covers expenses up to 7.5 percent of income. Hence, taxpayers aged 62 and over – regardless of their income level - may deduct all qualified medical and dental expenses, if they itemize their deductions.

A total of 17,047 elderly Oregon taxpayer households with adjusted gross incomes over $100,000 took advantage of the additional Oregon deduction in 2000 (Table 1).

On average, these wealthy elderly taxpayer households saved about $506 in state taxes.

Wealthy households benefiting from Oregon's additional medical care deduction saved $506, on average.

Table 1: Average state tax savings for households with AGI over $100,000; Medical and dental expense tax deductions, Oregon			
	Number of households	**Average deduction taken**	**Average state tax savings[4]**
Federal tax deduction for medical and dental expenses	4,208	$11,181	$1,006
Additional Oregon deduction for the elderly	17,047	$5,621	$506

Source: OCPP analysis of IRS Statistics of Income data for 2001, Oregon Department of Revenue data for 2000.

The cost of helping the wealthy with medical care

The federal and Oregon tax breaks for medical costs reduce the amount of General Fund revenues available to pay for human services, public schools, state police, and other state government services. The OCPP estimates that the federal medical care deduction for taxpayers with incomes over $100,000 will cost Oregon $9.9 million in the 2003-05 biennium, while the additional Oregon deduction will cost $26.3 million. In total, these two tax breaks for well-off Oregonians will cost the state $36.3 million in the next biennium (Table 2).[5]

Medical care tax breaks for the wealthy will cost Oregon $36 million in 2003-05.

Table 2: Estimated Oregon revenue impact from two tax breaks for medical and dental expenses, portion benefiting households with AGI over $100,000	
	Estimated revenue impact, 2003-05
Federal tax deduction for medical and dental expenses	$9.9 million
Additional Oregon deduction for the elderly	$26.3 million
Total	$36.3 million

Source: OCPP analysis of Oregon Department of Revenue data, IRS data. See Endnote 5.
Note: The revenue impact of the federal and Oregon tax breaks do not appear to add up to the total listed because the numbers have been rounded.

These revenue impacts are based on the assumption that the deductions would disappear once household income hit $100,000. Legislators may wish to "phase-out" the deductions instead, so that the deductions would disappear gradually at incomes around $100,000. The revenue impact of such a phase-out would depend on how it was structured.[6]

A matter of priorities

The Medically Needy program provided life-saving prescription drugs to vulnerable Oregonians. In one notable case, Douglas Schmidt of Portland fell into a coma after losing access to prescription drugs for epileptic seizures when the Medically Needy program was eliminated on February 1.[7]

The medical care tax breaks, on the other hand, are typically a luxury for their wealthy recipients. Most Oregonians with high incomes can afford and are eligible for medical insurance to cover many medical and dental procedures. Access to insurance substantially limits out-of-pocket costs. To the extent they have out-of-pocket costs, wealthy Oregonians are in a good position to afford them. As mentioned earlier, the 17,047 wealthy senior households whose medical and dental costs were subsidized through the additional Oregon deduction accrued on average tax savings of about $506. Oregonians with $100,000 or more in income likely are able to afford to meet these expenses on their own.

Given the bleak state budget outlook and the plethora of programs and services facing deep cuts or complete elimination, including the Medically Needy program, Oregon policy makers should reconsider the decision to subsidize the medical costs of affluent households.

Arguably, the federal deduction has a more compelling policy purpose, since it subsidizes only the medical and dental expenses of Oregonians whose medical costs exceed a high portion of their income. However, allowing wealthy Oregonians to take this federal deduction on their state tax returns may no longer be a high priority in today's budget environment. Even if Oregon chose not to allow medical deductions for households with incomes over $100,000, they would still receive tax savings on their federal taxes. In a period of insufficient state tax revenues and difficult state budget decisions, legislators should be asking whether Oregon should prioritize this spending for wealthy Oregonians who, in most cases, can afford the additional costs. Their state tax savings average $1,006 per household, or less than 1 percent of their income.[8]

In 2001, only 7 percent of Oregon households had adjusted gross incomes over $100,000 (Table 3). Therefore, at least 93 percent of Oregon taxpayers would not be affected by the policy changes proposed in this issue brief.

93% of taxpayers filed returns showing less than $100,000 Adjusted Gross Income.

Table 3: Oregon tax returns, 2001, by AGI level

	Number of returns	Percent of all returns
Total returns	1,571,716	--
Returns with AGI over $100,000	112,234	7%
Returns with AGI under $100,000	1,459,482	93%

Source: OCPP analysis of IRS Statistics of Income data, tax year 2001.

The contrast between the medical tax break for wealthy households and the elimination of the Medically Needy program is one of the starkest examples of Oregon's misplaced spending priorities. After addressing this issue, Governor Kulongoski and the Legislative Assembly should look for other tax expenditures that are out of line in today's budget environment so that they can restore quality state services. Doing so would be an important step toward putting Oregon's priorities back in order.

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Endnotes

[1] The Tax Expenditure Report is available from the Budget and Management section of the Department of Administrative Services, and is available online from the Department of Revenue at http://www.dor.state.or.us/statistics.html.

[2] According to the Oregon Department of Human Services, 285 clients with HIV/AIDS and 132 clients with organ transplants were identified as eligible for this small, short-lived program. Email to author from Cathy Cooper, Department of Human Services, on May 22, 2003.

[3] "Co-Chair 2003-2005 Budget Proposal," Joint Committee on Ways and Means, April 17, 2003. Accessed at http://www.leg.state.or.us/comm/lfo/Co_Chair_Budget_Ver1.pdf.

[4] Average state tax savings assumes all tax break beneficiaries used the deduction to reduce income in the 9 percent income tax bracket.

[5] OCPP employed the following technique to estimate the revenue impact of the two tax breaks. First, OCPP used IRS Statistics of Income data on Oregon returns to determine the total amount of federal deductions for medical and dental expenses claimed by taxpayers with AGI over $100,000 each year from 1997 to 2001. The OCPP then determined the average annual rate of growth in the federal deduction taken by taxpayers with AGI over $100,000. While the average annual growth rate was 20.3 percent from 1997 to 2001, the rate of growth was slower in later years than it had been earlier. From 2000 to 2001, for instance, the rate growth rate was 6.6 percent. Hence, the OCPP estimated that from 2002 to 2004, use of the deduction would grow at an annual rate of 6.6 percent. Using this method, the OCPP estimated the total medical and dental deductions that will be claimed by taxpayers with AGI over $100,000 in 2003 and 2004. Revenue impact was estimated by multiplying the estimated total deduction by 9 percent, the highest income tax bracket. OCPP followed a similar procedure to estimate the revenue impact of the Oregon deduction for medical and dental expenses. In this case, OCPP used Oregon Department of Revenue data to determine the total amount of medical and dental deductions taken by taxpayers with AGI over $100,000 each year from 1997 to 2000 (data for 2001 was not publicly available). Average annual growth in the deduction taken by well-off Oregonians from 1997 to 2000 was 18.3 percent, and the growth rate was consistent across the years examined. Therefore, OCPP applied an 18.3 percent annual growth rate to estimate the deduction that would be taken by well-off Oregonians in 2003 and 2004. Once again, revenue impact was estimated by multiplying the estimated total by 9 percent.

[6] Using a different methodology, the Legislative Revenue Office's preliminary estimate is that the total savings from the two tax changes would be $29 million. More specifically, LRO estimates a revenue impact of $16.3 million from capping use of the Oregon deduction at $100,000 AGI, and $12.7 million from capping the federal deduction at the same AGI level. LRO estimates are designed using a statistical model that predicts revenue impact based on a sample of Oregon tax returns from 2000. In this case, LRO's model assumes the deductions will grow at the same rate as the general economy. This may mean that LRO's estimate is low, both because medical costs (and medical deductions taken through these tax breaks) are outpacing inflation, and because Oregon's elderly population is growing faster than the population at large. Drawing on data from the latest revenue forecast, LRO's statistical model takes shifts in the number of high-income households into account, while OCPP was not able to take this factor into account, due to lack of access to detailed data. This may be one reason why LRO's estimate is lower than the OCPP's. On the other hand, OCPP applied the $100,000 threshold to all tax filers, while LRO applied the $100,000 threshold to joint tax filers and a $50,000 threshold to single filers. This difference would tend to make the LRO estimate higher than the OCPP's. While the two estimates are different, they both show significant savings if the deductions are eliminated for wealthy Oregonians.

[7] Colburn, Don. "Coma Exemplifies Potential Toll from Budget Cuts." *The Oregonian*, April 15, 2003, p. A01.

[8] However, to protect those few wealthy Oregonians with extremely high out-of-pocket medical costs, Oregon might choose to retain the federal deduction and eliminate only the additional Oregon deduction for well-off households. OCPP estimates this would provide $26 million in additional revenue.