Senate Committee On Finance

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I deeply appreciate the opportunity to speak to you today.

Other speakers today will address the human impact of the lack of a medical deduction as well as the impact on health care system. I'll focus my remarks on taxes. The three points that I will address are:

- Why the medical deduction should be treated differently, and in fact, IS treated differently in other states than other types of deductions.
- How the data that has been presented to the committee by the Joint Fiscal office and the tax department supports this reasoning.
- How allowing the Medical Deduction protects the integrity of the tax system.

I want to acknowledge up front that I am not providing an answer to the question of how to replace the revenue lost to the medical deduction. I would note that the initial estimate of an impact of the deduction at over $5,000,000 has been reduced to $3.5mm. I suggest that the impact may be even less through raising the floor below which no deduction would be allowed as well as a review of what is actually deductible and when.

My hope is that the legislature will continue this dialogue with a deeper understanding than the body had last spring and realize that if you knew then, what you know now, you would not have eliminated the medical deduction and would have raised the revenue by other means.

Let me start at a 10,000 foot view of taxation. The premise behind raising revenue to support public works by way of a tax on income is that we feel income is a reasonable basis of measuring resources; the individual's means to pay. So, if we base our tax system on income, we are then faced with the challenge of defining what is income?

Is income simply what comes into a particular household?

Or is income a more complicated calculation which assesses a particular household's income over which it has discretion?

The first approach, while simple, creates inequities which ultimately will cause its unraveling.

The second approach provides more fairness but requires us to use care given the impact on economic, social, and clearly fiscal matters.

You have been well schooled on changes that have been made at the federal and the state level over the last 18 months, but I'd ask you hang with me for a minute to review an exhibit which I hope will help frame the conversation.

The attached exhibit gives a side by side comparison of the Federal and Vermont changes relevant to today's discussion. The calculation of Adjusted Gross Income is relatively unchanged, other than increasing the exclusion of Social Security Income. Under federal law and formerly under Vermont law, there are Itemized Deductions that are added together and if they exceed the Standard Deduction, then we can (or could) reduce our taxable income by that amount.

If you agree with me, or at least will entertain the idea, that the fairer system zeros in on the income over which you have discretion, income that you can choose how to spend it (or save it), then I think it is logical to look at itemized deductions with an eye toward control and discretion. Do we have a choice as to whether we incur the expense or not?

Using this as a frame for reviewing itemized deductions, I believe is informative. Look over the list of the deductions, past and present, on the exhibit:

- We don't have control over State Income Taxes, but then again, it seems a bit confusing to have a deduction for the item that you're actually trying to arrive at in your calculation to start with (a bit like a dog chasing his tail).

- The deduction of Real Estate Taxes begins to illustrate my point. We choose where we live and how expensive a home we live in. If we choose to live in a large house, we are likely to pay more Real Estate Taxes than if we live in a smaller house. If we'd rather not pay high real estate taxes, we can choose to live in a smaller house or in a less expensive community.

- Similarly, with Mortgage Interest, if we load up our balance sheet with a lot of debt, we're going to pay a lot of interest expense. We can choose to live in a less expensive house and cut back our spending.

- The Miscellaneous Itemized Deductions are not so much discretionary as they are controllable. You can shop around and get a lower fee for managing your investments or preparing your tax return or you can do it yourself. You can negotiate with your employer to have those expenses that you incur to do your job paid for by the employer.

I'll skip over Charitable Contributions because the legislature has arrived at a compromise on the deduction by replacing it with a limited tax credit.

This leaves us with Casualty Losses and Medical Expenses. Do we have a choice to incur these expenses? I won't address Casualty Losses today other than to say that if we have another Irene experience in the state, the legislature is likely to face a similar call to what you're hearing on the Medical Deduction. Why am I getting relief from a Casualty Loss deduction on my federal return and yet I'm not getting similar relief from Vermont?

Which leads me to my point on Medical Expenses. We have no control over our health or the health of our loved ones. There isn't a person here, that faced with a loved one who needs health care that is beyond the scope of Health Insurance, who needs care and comfort in their final days which is not covered by Health Insurance, or who needs a therapeutic residential treatment, who would not incur these costs?

These are not voluntary or controllable expenses. The individual or the family has no discretion as to whether or not to incur the expense.

For this reason, I strongly state that expenses incurred for healthcare should reduce the base of income on which Vermont, or any jurisdiction for that matter, assesses Income Taxes. There is a reason why Massachusetts, a state that doesn't allow itemized deductions, allows a special deduction for Medical Expenses. It is a fairer, more just method of arriving at income on which to assess taxes.

I understand that the Legislature is facing the challenge of generating revenue. The Joint Fiscal Office has provided the analysis of the impact of the Medical Deduction to be in excess of $5,000,000. The tax department subsequently modified the figure to measure the impact of medical expense in excess of the 10% AGI floor limits allowed on the federal return and further in excess of the new Vermont Standard deduction to reduce their estimated cost to $3,500,000.

The Joint Fiscal Office has said that this impacts roughly 2,500 taxpayers. We are tempted to use an average and say that the cost to an individual taxpayer is only $1,400. The Tax Department and the Joint Fiscal office have told us that the majority of the cost is with even fewer taxpayers. The problem with averages is that it misses the anomalies. In my practice, I face the anomalies. You'll hear, as no doubt you have heard, similar stories but in my modest practice, I have clients who have written a check for $7,000 and $10,000 to the State of Vermont on their 2018 tax returns due to elimination of the Medical Deduction. I would hope that any resolution of the matter will provide relief of these high-end anomalies as opposed to the Charitable Deduction solution which caps the credit at the high end.

I have heard it said that these folks have the money to pay the Medical Expense, so they can pay the tax. To look at the income levels presented by the tables provided by the Joint Fiscal office and the Tax Department, it is easy to come to this conclusion. But given two houses with the same income level, one spending 50% of their income on Medical expenses and the other spending their income on lifestyle, is it fair that they both pay the same taxes? I suggest not.

But if you conclude otherwise, in the cases that I have witnessed where there are high medical costs, the taxpayers have higher income exactly due to the fact that they have high medical costs. They have had to accelerate the recognition of income through tapping retirement accounts or selling appreciated assets in order to cover expenses. These are not $150,000 to $250,000 income households. These are households whose typical income is significantly lower. Don't cast them in a higher lot simply based on their income.

While we all wish for simplicity, simplicity when it comes to taxes runs afoul of integrity. A tax system that doesn't address the more complex nuances of life, loses integrity and eventually frays the moral fabric on which it depends.

There is precedence in the Vermont Tax System. We do not charge sales tax on prescriptions, over the counter drugs, or medical equipment. It seems logical that where income is used to pay for medical care, it should not be taxed.

I am going to pivot here and say that this is true both as to what is deductible and it is also true of how we define what is deductible. On the question of the Medical Deduction for Eldercare, I listened to the Tax Commissioner's testimony before this committee last Friday on which he noted that care communities provide an actuarily calculated figure as to what fees are specific to medical expenses. As a practitioner who sees these calculations from numerous service providers, I would suggest it prudent for the Tax Department, likely working with Banking and Insurance, provide guidelines to care communities as to how these calculations are done to provide more consistency and clarity.

Taxpayers who are incurring cost of eldercare should get to deduct these costs. To not do so has the potential to disrupt a significant premise on which eldercare services are priced and delivered in the state. Care communities which provide a mix of full pay and Medicaid residence depend on a certain level of full pay residence to support their operations. They depend on the full pay residence to enable them to provide a lower price to the State for Medicaid residence.

It is a logical conclusion that if the tax system discourages full pay residence in care communities, either by the acceleration of the depletion of assets through taxation, finding alternative states for that care where the expenses is deductible, or further incentivizing people to do Medicaid Planning shifting the burden to pay to the state, the cost of Medicaid to the state will increase.

Denying a deduction for Medical Expenses harms our most vulnerable neighbors. While it provides a short-term fix for revenue, it causes severe long term problems with costs of care covered by the State and it frays the social contract on which the tax system is based.

VERMONT INCOME TAX
OVERVIEW OF CHANGES AND THEIR IMPACT ON VERMONT
2018 and ON

Add Up INCOME (Wages, Investment Income, Business Income, Retirement Distributions, Social Security, etc.)

Subtract ADJUSTMENTS TO INCOME (Retirement Contributions, Self Employed Health Insurance, Health Savings accounts, etc.)

To Arrive at ADJUSTED GROSS INCOME

Add Up ITEMIZED DEDUCTIONS (Schedule A on Federal Form 1040)

	Federal Law		Vermont Law	
ITEMIZED DEDUCTIONS PAST AND PRESENT	**Pre 2018**	**2018 Forward**	**Pre 2018**	**2018 Forward**
Medical Expenses	Excess over 7.5% AGI	Floor increased to 10% in 2019	Same as Federal Law	NO ITEMIZED DEDUCTIONS
Taxes State Income Taxes or Sales Taxes Real Estate Taxes	No Limit	Limited to $10,000 Total	Limited Same as Federal	
Interest Home Mortgage Home Equity Loan (Not used for Home) Investment	On up to $1mm On up to $100k Up to Income	New Debt 750k No Deduction No Change	Same as Federal	
Charity Gifts of Cash Gifts of Cash	Limit based on AGI	Higher AGI Limits	Same as Federal	
Casualty and Theft Losses	Excess over 10% AGI	Now only in Declared Disaster	Same as Federal	
Miscellaneous Expenses Unreimbursed employee expenses Tax Preparation Fees Investment Expenses	Combined In Excess of 2% AGI	Not Deductible	Same as Federal	
Total Itemized Deductions				
Or take STANDARD DEDUCTION if higher				
Single	$ 6,350	$ 12,000	Same as Federal	$ 6,000
Head of Household	$ 9,350	$ 18,000		$ 9,000
Married	$ 12,700	$ 24,000		$ 12,000
65 or Over	Add $1,250	Add $1,300		Add $1,000
Take the Greater of Itemized Deductions or Standard Deduction				
EXEMPTIONS	$4,050	No Deduction	Same as Fed	$4,150
TAXABLE INCOME				
TAX RATES	10-39.6%	10-37%	3.55% to 8.95%	3.35% to 8.75%

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