THE FINANCIAL IMPACT OF ALLOWING DEPRECIATION AS A BUSINESS EXPENSE WHEN DETERMINING ELIGIBILITY FOR HEALTH CARE PROGRAMS

A Report from the Office of Vermont Health Access to the
Senate Appropriations Committee
House Appropriations Committee
Senate Health and Welfare Committee
House Health Care Committee

January 6, 2010

Summary

Section 23 of Act 61, passed during the 2009 legislative session, states the following:

No later than January 15, 2010, the office of Vermont health access shall report to the house committees on appropriations and on health care and the senate committees on appropriations and on health and welfare on the financial impact of modifying the income eligibility rules to allow depreciation as a business expense effective upon approval of the waiver amendment pursuant to Sec. 22(a)(2) of this act. The report shall include an analysis of estimated increases in enrollment, impacts on the premium amounts paid by the enrollees, and increases in federal funds due to the rule change.

The analysis described in this report found that allowing depreciation as a deduction from self-employment income when determining eligibility for health care assistance programs would most likely cost approximately $81,000 in state funds for the last five months of SFY10 (assuming a February 1, 2010, implementation date) and $266,400 in SFY11, assuming that the policy change would be phased in for active cases over a 12-month period beginning on February 1, 2010. If the policy change were implemented at a single point in time, rather than phased in as beneficiaries reach their 12-month review, the cost in SFY11 would be $281,700; however, it would be administratively very difficult to implement this change for all beneficiaries at the same time.

It is likely that the cost of this policy change is understated, since it was not possible to include in the estimated cost the impact of individuals who may have been denied coverage in the past, but who subsequently learn that depreciation is now an allowable expense, and therefore reapply for benefits.

Due to the fact that the Centers for Medicare and Medicaid (CMS) have not yet approved Vermont's request for a waiver amendment to allow depreciation as a business expense deduction, it is highly unlikely that implementation can occur on February 1. CMS has indicated that it will not consider the waiver amendment request until and unless the Vermont legislature restores funding for this policy change.

OVHA worked closely with Joint Fiscal Office to develop the cost estimates based on the results of the case reviews described in the methodology section of this report.

The types of businesses owned by the beneficiaries in the active cases sample were quite diverse. Of the people who would change categories if depreciation were allowed, almost half were in the construction business (carpenters and painters). Other lines of work included rental property, sandwich shop, hair salon, massage, house cleaning, flea market sales, upholstery, and child/adult day care. There was only one farmer in the sample. Monthly depreciation deductions in the sample as a whole ranged from $0 to $2347.50. Approximately 14% of the depreciation amounts exceeded $1000 per month.

Background

The Internal Revenue Service defines "depreciation" in its Schedule C instructions as "the annual deduction allowed to recover the cost or other basis of business or investment property having a useful life substantially beyond the tax year."

The majority of the assistance programs administered by the Department for Children and Families' Economic Services Division (DCF/ESD) do not allow depreciation as a business expense when calculating income for purposes of determining eligibility. These programs include Reach Up, 3SquaresVT (formerly food stamps), fuel assistance, and most health care programs, including Medicaid, VHAP, and Catamount and ESIA premium assistance. Dr. Dynasaur is the only program that allows depreciation as a business expense. The policy decision to allow depreciation as a business expense for Dr. Dynasaur was made at the time Dr. Dynasaur was implemented to align the eligibility determination process with the Department of Health's Women, Infants, and Children program.

Federal regulations for 3SquaresVT prohibit the use of depreciation as a business expense when determining eligibility. Federal regulations for other programs are silent on this issue.

When DCF/ESD eligibility workers (called "Benefit Program Specialists" or "BPSs") receive an application from a self-employed person, they request the person to submit the most recently filed tax return, which will include an IRS Schedule C, the Profit or Loss from Business form. When computing countable income for the eligibility determination process, a BPS will use the net income from Schedule C (which allows deductions from gross income for advertising, labor costs, insurance, office costs, supplies, travel, meals, and other business expenses); however, the BPS will add the depreciation cost to net income to reach the countable income amount.

Methodology used to develop the cost estimate

DCF/ESD searched the eligibility database to find all self-employed VHAP, premium assistance, and Healthy Vermonters beneficiaries with active cases for the four-month period of February through May of 2008. Medicaid beneficiaries were not included in the pool of potentially affected beneficiaries since they are already below 100% of the Federal Poverty Level (FPL) and would therefore not become eligible for a different category of health care assistance were depreciation allowed as a business expense. Dr. Dynasaur children were not included because depreciation is already an allowable business expense deduction in that program. In addition, a list was produced of self-employed VHAP, Medicaid, and premium assistance beneficiaries whose coverage ended during the four-month sample period because their income exceeded 300% FPL.

The self-employed population for the four-month period included 6393 active VHAP and premium assistance cases, 100 Healthy Vermonter cases, and 99 closed cases. From these three pools random samples were chosen to produce a cost estimate with a 95% confidence level and a 10% margin of error. A DCF/ESD central office eligibility expert then manually recomputed eligibility for all cases in the sample and recorded the results, which were then extrapolated to the entire population.

Results of sample evaluation

For approximately one third of the cases active in VHAP or the premium assistance programs, allowing depreciation as a business expense would either change their health care category (for example, a person on Catamount Health premium assistance would qualify for VHAP), or reduce their monthly premium (for example, someone on VHAP would have a premium of $7 instead of $49). In some cases the loss of premium revenue was more than offset by savings in the per-member-per-month (PMPM) cost, since the Catamount Health PMPM is higher than the VHAP PMPM.

In the sample of Healthy Vermonters cases, approximately 45% would become eligible for either premium assistance or VHAP if depreciation were allowed as a business expense. Since Healthy Vermonters is a pharmacy discount program that requires no state program costs, any shift from Healthy Vermonters to other assistance categories would be a new cost.

In the sample of closed cases approximately 50% would have remained eligible for a component of health care assistance had depreciation been an allowed business expense deduction. Specific data on cases with self-employment income that were denied over the five-month sample period could not be obtained, so an estimate of the cost of denials was derived by evaluating the total number of health care denials vs. closures over a several-month period. It was found that there was an average of 3.3 times as many closures as denials; therefore, the estimated cost of the closures in the sample was divided by 3.3 to determine an estimated denial cost.

Below is a breakdown of the costs for each category:

Active cases

	SFY 10	SFY 11
Gross	$37,530.13	$216,533.04
Net	$15,421.13	$89,384.84

Healthy Vermonters

	SFY 10	SFY 11
Gross	$78,235.90	$211,272.90
Net	$32,147.13	$87,213.45

Closed cases

	SFY 10	SFY 11
Gross	$62,451.20	$166,998.18
Net	$25,661.20	$68,936.85

Denied cases

	SFY 10	SFY 11
Gross	$18,924.61	$50,605.51
Net	$7,776.12	$20,889.95

TOTAL

	SFY 10	SFY 11
Gross	$197,141.84	$645,409.63
Net	$81,005.58	$266,425.10